



DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9971]

RIN 1545–BN89

Exception for Interests Held by Foreign Pension Funds

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations regarding gain or loss of a qualified foreign pension fund attributable to certain interests in United States real property. The final regulations also include rules for certifying that a qualified foreign pension fund is not subject to withholding on certain dispositions of, and distributions with respect to, certain interests in United States real property. The final regulations affect certain holders of interests in United States real property and withholding agents that are required to withhold tax on dispositions of, and distributions with respect to, such property.

DATES: Effective Date: These regulations are effective on **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Applicability dates: For dates of applicability, see §§1.897(l)-1(g), 1.1441-3(c)(4)(iii), 1.1445-2(e), 1.1445-5(h), 1.1445-8(j), 1.1446-7.

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SUPPLEMENTARY INFORMATION:

Background

Section 897(l) was added to the Internal Revenue Code (the “Code”) by section 323(a) of the Protecting Americans from Tax Hikes Act of 2015, Pub. L. 114-113, div. Q (the “PATH Act”), and amended by section 101(q) of the Tax Technical Corrections Act of 2018, Pub. L. 115-141, div. U. In the preamble to the updated section 1445 regulations that were published in the **Federal Register** (81 FR 8398-01, as corrected at 81 FR 24484-01) on February 19, 2016, the Department of the Treasury (the “Treasury Department”) and the IRS requested comments regarding what regulations, if any, should be issued pursuant to section 897(l)(3). The Treasury Department and the IRS considered all of the comments received in response to this request and, on June 7, 2019, published proposed regulations under sections 897(l), 1441, 1445 and 1446 in the **Federal Register** (84 FR 26605) (the “proposed regulations”). The proposed regulations contained rules relating to the qualification for the exemption under section 897(l), as well as rules relating to withholding requirements under sections 1441, 1445 and 1446, for dispositions of United States real property interests (“USRPIs”) by foreign pension funds and their subsidiaries and distributions described in section 897(h).

This Treasury decision finalizes the proposed regulations, after taking into account and addressing comments received by the Treasury Department and the IRS with respect to the proposed regulations. Terms used but not defined in this preamble have the meaning provided in the final regulations.

Comments outside the scope of this rulemaking are generally not addressed but may be considered in connection with future regulations. All written comments received in response to the proposed regulations are available at www.regulations.gov or upon request.

Summary of Comments and Explanation of Revisions

The final regulations retain the general approach and structure of the proposed regulations, with certain revisions. This Summary of Comments and Explanation of

Revisions section discusses the revisions as well as comments received in response to the solicitation of comments in the proposed regulations.

I. Comments and Revisions Related to the Scope of the Exception

A. Qualified controlled entities

Under the proposed regulations, and consistent with section 897(l), gain or loss of a qualified foreign pension fund (“QFPF”) or a qualified controlled entity (“QCE”) (under the proposed regulations, each generally a “qualified holder”) from the disposition of a USRPI is not subject to section 897(a). Prop. §1.897(l)-1(b)(1). The proposed regulations defined a QCE as a trust or corporation organized under the laws of a foreign country,¹ all of the interests of which are held directly by one or more QFPFs or indirectly through one or more QCEs or partnerships. Prop. §1.897(l)-1(d)(9).

1. Ownership by Non-QFPFs

Several comments received in response to the proposed regulations addressed the ownership requirement with respect to QCEs. The proposed regulations did not permit ownership of a QCE by a person other than a QFPF or another QCE, declining to adopt a comment received before the publication of the proposed regulations requesting that de minimis ownership of a QCE by other persons be disregarded under certain circumstances, such as when de minimis ownership by managers or directors is required by corporate law in certain jurisdictions. The Treasury Department and the IRS determined that permitting a person other than a QFPF or another QCE to own an interest in a QCE would impermissibly expand the scope of the exception in section 897(l) by allowing investors other than QFPFs to avoid tax under section 897(a).

¹ For consistency with other guidance, the final regulations adopt the term “foreign jurisdiction” instead of “foreign country.” See §1.897(l)-1(e)(4). See also Part II.C. of this Summary of Comments and Explanation of Revisions for a description of how the final regulations treat subnational tax regimes.

However, under the proposed regulations, a QFPF could invest in USRPIs with non-QFPFs through a partnership and still qualify for the exemption under section 897(l).

Comments received in response to the proposed regulations similarly requested that the final regulations allow a de minimis exception for the ownership of a QCE by other persons. One comment reiterated that de minimis ownership, including by managers or directors, may be required by corporate law in certain jurisdictions and suggested that the final regulations include a rule that would permit an entity to be treated as a QCE if a small amount (for example, five percent) of the entity is held by a non-QFPF. The comment also suggested that, in order to prevent non-QFPF entities from inappropriately accessing the exemption under section 897(l), a non-QFPF de minimis owner of a QCE could be required to recognize gain or loss on any disposition of a USRPI held through the QCE under section 897(a). The comment asserted that there is no policy reason to differentiate between entities with QFPF and non-QFPF owners/beneficiaries because the entity is a corporation or trust rather than a partnership, and that permitting de minimis non-QFPF ownership of a QCE would allow QFPFs flexibility with regard to the form of entity chosen for investment purposes.

Another comment asserted that a de minimis exception should be allowed because certain jurisdictions may require or otherwise allow investment arrangements in which foreign pension funds pool investments with non-QFPFs. The comment argued that such investment arrangements should not be precluded from qualifying for the exception under section 897(l), especially if those arrangements are allowed or required by local law and are consistent with generally accepted investment practice. The comment suggested that the final regulations permit a non-QFPF to have a de minimis level of ownership (for example, five percent) in a QCE. If a de minimis exception were not adopted, the comment suggested several alternatives to prevent minority investors from tainting the QFPF status for the majority QFPF investors,

including that the final regulations allow QFPFs to qualify for the exception under section 897(l) on their share of income or gains distributed by an investment vehicle, provided the investment vehicle is majority owned by QFPFs. The comment also suggested that the QCE ownership requirement be modified to permit an eligible fund that is a non-QFPF solely because it has a single qualified recipient with a right to more than five percent of the assets or income of the eligible fund to be an owner of a QCE. The comment requested that, in that circumstance, the final regulations look through to the owners of the non-QFPF and apply the prohibition on a single five-percent beneficiary or participant by reference to the would-be QCE rather than the non-QFPF.

An additional comment suggested that a QFPF should be able to claim the section 897(l) exemption with respect to gains derived by an entity in which the QFPF is an investor where the entity is not a partnership and also is not a QCE because it is not wholly owned by QFPFs. The comment noted that, in certain foreign government facilitated arrangements involving a partnership formed under local law through which multiple foreign government entities jointly invest, the investment entity may be a per se corporation under §301.7701-2(b)(6) that would not qualify as a QCE if not all of the government investors were QFPFs. The comment asserted that, in such circumstance, investors would be forced to include a non-government partner so that the investment entity could be treated as a partnership for U.S. federal tax purposes. To address this concern, the comment recommended that the final regulations provide that, if an entity is treated as a partnership under the law of the country in which the QFPF is formed, the QFPF should be able to treat its distributive share of partnership Foreign Investment in Real Property Tax Act ("FIRPTA") gains as exempt under section 897(l).

The Treasury Department and the IRS continue to believe that allowing any exception with respect to the ownership of a QCE would impermissibly expand the scope of the exception in section 897(l) by allowing investors other than QFPFs to avoid

tax under section 897. Section 897(l)(1) expressly provides that an entity must be wholly owned by a QFPF to constitute a QCE and qualify for the exception under section 897(l). Accordingly, the final regulations do not provide a de minimis exception to the ownership of a QCE. For the same reasons, the final regulations do not adopt other suggested approaches that would permit an entity to be a QCE despite limited non-QFPF ownership, such as a tracing approach that would require non-QFPF owners of an entity to be subject to section 897(a) and allow only QFPF owners to benefit from the section 897(l) exemption, or a look-through approach that would allow a non-QFPF that cannot qualify as a QFPF because it violates the rule against having a single five-percent beneficiary or participant to own an interest in a QCE.

The final regulations also do not adopt the recommendation to permit a QFPF to benefit from the section 897(l) exemption with respect to interests in an entity that is classified as a corporation for U.S. federal tax purposes but that does not qualify as a QCE due to ownership by non-QFPFs by treating the entity as a partnership in accordance with its treatment under applicable foreign law. In addition to expanding the definition of a QCE to permit ownership by non-QFPFs, such a rule would contradict the classification of the entity for U.S. federal tax purposes.

2. Investment Arrangements with QFPFs

The proposed regulations permitted multiple QFPFs to wholly own a QCE, either directly or indirectly through one or more other QCEs, in recognition that it is common for QFPFs to pool their investments.

One comment discussed the interaction between the requirement that QCEs must be wholly owned by QFPFs and the various requirements that an eligible fund must meet to maintain its status as a QFPF. The comment stated that a QFPF that invests with other QFPFs in a QCE might fail to qualify for the section 897(l) exemption solely because one of its co-investors fails to qualify as a QFPF in any given year. The

comment noted that QFPFs would be required to negotiate complex protections to shield against another co-investor from tainting the QCE's status. The comment further noted that investing through a partnership (which would allow the QFPF to invest with other non-QFPFs) may not be feasible because a foreign jurisdiction may have regulatory restrictions regarding the types of legal entities in which pension funds may invest or the entity may be wholly owned by QFPFs that form part of a single government (and thus may be a per se corporation under §301.7701-2(b)(6)). The comment therefore recommended that the final regulations provide a rule that a QCE that inadvertently fails to constitute a qualified holder because one of its owners ceases to be treated as a QFPF be permitted, for a limited time, to partially benefit from section 897(l) to the extent that it continues to be owned by QFPFs.

The final regulations do not provide an exception to the requirement that a QCE be wholly owned by a QFPF to insulate QFPF investors from the risk of losing QCE status in investment arrangements with other QFPFs. As with a de minimis exception to the ownership of a QCE, the Treasury Department and the IRS believe that any such rule would impermissibly expand the scope of the section 897(l) exception to allow investors other than QFPFs to avoid tax under section 897. The Treasury Department and the IRS also believe that the changes to the final regulations described in Parts II.A.2 and II.A.3 of this Summary of Comments and Explanation of Revisions will appropriately alleviate concerns with respect to the risk that a QFPF may inadvertently fail to satisfy the requirements to constitute a QFPF.

3. Non-economic Ownership

As referenced in the preamble to the proposed regulations, given the absence of an express provision to the contrary, the definition of an "interest" for purposes of determining whether an entity is a QCE is determined in accordance with §1.897-1(d)(5), which provides that an interest in an entity means an interest in such entity

other than an interest solely as a creditor. Section 1.897-1(d)(3) provides that an interest in an entity other than solely as a creditor is: (A) stock of a corporation; (B) an interest in a partnership as a partner within the meaning of section 761(b) and the regulations thereunder; (C) an interest in a trust or estate as a beneficiary within the meaning of section 643(c) and the regulations thereunder or an ownership interest in any portion of a trust as provided in sections 671 through 679 and the regulations thereunder; (D) an interest which is, in whole or in part, a direct or indirect right to share in the appreciation in value of an interest in an entity described in subdivision (A), (B), or (C) of §1.897-1(d)(3)(i) or a direct or indirect right to share in the appreciation in value of assets of, or gross or net proceeds or profits derived by, the entity; or (E) a right (whether or not presently exercisable) directly or indirectly to acquire, by purchase, conversion, exchange, or in any other manner, an interest described in subdivision (A), (B), (C), or (D) of §1.897-1(d)(3)(i).

One comment requested that the final regulations clarify that non-economic interests in an entity are not taken into account in determining whether an entity is a QCE. The comment noted that such a situation might arise when a foreign partnership that elects to be treated as a corporation for U.S. federal income tax purposes has a general partner that holds no economic interest in the entity. The comment recommended that the final regulations provide that interests in a QCE that do not entitle the holders to share in the income or assets of the QCE should be ignored in determining whether the QCE is a qualified holder, noting that such fully non-economic interests do not present potential for abuse and that disregarding those interests would be consistent with congressional intent to accommodate a variety of foreign pension fund structures under section 897(l).

The Treasury Department and the IRS do not believe that additional guidance is necessary regarding the ownership interests taken into account in determining whether

an entity constitutes a QCE. Thus, an “interest” for purposes of determining whether an entity is a QCE is determined under §1.897-1(d)(3). Whether an interest in an entity constitutes one of the interests listed under §1.897-1(d)(3) or is instead disregarded is determined based on the facts, taking into account general tax principles.

B. Qualified holder rule

The proposed regulations provided that a qualified holder does not include any entity or governmental unit that, at any time during the testing period, determined without regard to this limitation, was not a QFPF, a part of a QFPF, or a QCE (the “qualified holder rule”). See Prop. §1.897(l)-1(d)(11)(ii). For this purpose, the proposed regulations provided that the testing period is the shortest of (i) the period beginning on the date that section 897(l) became effective (December 18, 2015), and ending on the date of a disposition described in section 897(a) or a distribution described in section 897(h); (ii) the ten-year period ending on the date of the disposition or the distribution; or (iii) the period during which the entity (or its predecessor) was in existence. See Prop. §1.897(l)-1(d)(14). Under the proposed regulations, the qualified holder rule does not apply to an entity or governmental unit that did not own a USRPI as of the date it became a QCE, a QFPF, or part of a QFPF. The preamble to the proposed regulations explained that the qualified holder rule is necessary to prevent the inappropriate avoidance of section 897(a) through QFPFs indirectly acquiring USRPIs held by foreign corporations that would not have otherwise qualified for the exception under section 897(l).

Comments recommended that the final regulations either modify the qualified holder rule or implement one of several alternatives. Comments agreed that the QFPF exception should not apply to exempt gain that would otherwise have been subject to tax under section 897. However, the comments argued that the qualified holder rule in the proposed regulations was overbroad because it could apply to any failure to qualify

as a QFPF or QCE in the testing period, even if the failure was unintentional or had no potential for abuse.

One comment requested that the final regulations provide a tolling period if there is an inadvertent failure to qualify as a QFPF and that failure is remedied in the following year. Another comment requested that the final regulations provide an exception to the qualified holder rule to exclude the situation in which a QFPF does not qualify solely because it fails to meet the requirements in proposed §1.897(l)-1(c)(2) (relating to the requirements an eligible fund must satisfy to be treated as a QFPF). The comment further recommended allowing a mark-to-market approach, whereby an election to recognize any net built-in gain at the time a QFPF acquires a non-QFPF that owns a USRPI could be made so that the non-QFPF could then be treated as a QCE with respect to any future disposition of its USRPI (similar to §1.337(d)-7(a) for the conversion of certain corporations to regulated investment companies (“RIC”) or real estate investment trusts (“REIT”)). In addition, the comment requested that the qualified holder rule be limited to apply only to USRPIs held by non-QFPFs when such non-QFPFs are acquired by a QFPF, resulting in a tracing approach that would prevent section 897(l) from applying only to a disposition of those specific USRPIs. The comment also recommended that the final regulations shorten the maximum testing period from ten to five years, which is consistent with the five-year maximum testing period for a RIC or REIT to be a domestically controlled qualified investment entity under section 897(h)(4).

As alternatives to the qualified holder rule, one comment requested that the Treasury Department and the IRS either allow a mark-to-market approach at the taxpayer’s election (similar to that suggested by other comments), under which the entity acquired by the QFPF would account for the gain when the entity is acquired by the QFPF, or require tracing the unrealized gain when the entity is acquired by a QFPF

or QCE so that section 897(a) can apply to the pre-acquisition gain upon a subsequent sale or exchange.

Under the final regulations, the substance of the qualified holder rule is the same as it was in the proposed regulations; however, for greater clarity, the final regulations identify the qualified holder rule as a separate requirement to qualify for the section 897(l) exemption rather than as part of the definitions. §1.897(l)-1(d). To be a qualified holder, a QFPF or a QCE must satisfy one of two alternative tests at the time of the disposition of the USRPI or the distribution described in section 897(h). §1.897(l)-1(d)(1). Under the first test, a QFPF or a QCE is a qualified holder if it owned no USRPIs as of the earliest date during an uninterrupted period ending on the date of the disposition or distribution during which it qualified as a QFPF or a QCE. §1.897(l)-1(d)(2). Alternatively, if a QFPF or a QCE held USRPIs as of the earliest date during the period described in the preceding sentence, it can be a qualified holder only if it satisfies the applicable testing period requirement, which is unchanged from the proposed regulations. §1.897(l)-1(d)(3).

The final regulations also include two transition rules. First, with respect to any period from December 18, 2015, to the date when the requirements of section 1.897(l)-1(c)(2) or (e)(9) first apply to a QFPF or QCE, as applicable (but in any event no later than **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, in the case of section 1.897(l)-1(c)(2), and no later than June 6, 2019, in the case of section 1.897(l)-1(e)(9)), the QFPF or QCE is deemed to satisfy the requirements of section 1.897(l)-1(c)(2) and (e)(9), as applicable, for purposes of section 1.897(l)-1(d)(2) and (3) if the QFPF or QCE satisfies the requirements of section 897(l)(2) based on a reasonable interpretation of those requirements (including determining any applicable valuations using a consistent method). Second, in determining whether a QCE is a qualified holder, solely with respect to the two tests in section 1.897(l)-1(d)(2) and (3), the final

regulations allow the QCE to disregard a de minimis interest owned by any person that provides services to the QCE from December 18, 2015 to **[INSERT DATE THAT IS 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]** (the “transition period”). §1.897(l)-1(d)(4)(ii). This second transition rule does not apply for purposes of determining QCE status under section 1.897(l)-1(e)(9) at the time of any disposition or distribution involving a USRPI. Thus, its application is limited to cases in which a trust or corporation failed to qualify as a QCE (and, therefore, as a qualified holder) during the transition period solely because of a de minimis interest owned by any person that provides services to the QCE (such as a manager or director). In that case, the transition rule allows the trust or corporation to eliminate the service provider’s ownership within the transition period and thereby avoid having to apply the tests for qualified holder status under section 1.897(l)-1(d)(2) or (3) by reference to the date that the service provider’s interest is eliminated. This may, for example, prevent the restarting of a ten-year testing period on the date that the service provider’s interest is eliminated. Any disposition of USRPIs during the period when the trust or corporation had the service provider as an interest holder still would not qualify for the section 897(l) exemption.

The Treasury Department and the IRS agree that the application of the qualified holder rule to an inadvertent failure to qualify as a QFPF could produce inappropriate results, particularly in the case where an eligible fund fails to meet the requirements in §1.897(l)-1(c)(2)(ii)(B)(2) because it unexpectedly projects that it will provide less than 85 percent retirement and pension benefits. Although the final regulations ultimately adopt the qualified holder rule without the changes recommended by the comments, the final regulations provide relief in the following ways:

- adding an alternative calculation to the requirements in §1.897(l)-1(c)(2)(ii)(B)(2) and (3) based on the average of the present values of the

future benefits expected to be provided, as determined in the 48 months preceding (and including) the most recent valuation (the “48-month alternative calculation,” described further in Part II.A.2 of this Summary of Comments and Explanation of Revisions);

- adding a definition of retirement and pension benefits;
- clarifying the scope of ancillary benefits; and
- allowing an eligible fund to provide a de minimis amount of non-ancillary benefits (described further in Part II.A.3 of this Summary of Comments and Explanation of Revisions).

Together, these changes provide relief to eligible funds that would otherwise unexpectedly fail to qualify as a QFPF in any given year and alleviate the underlying concerns regarding the breadth of the qualified holder rule.

In light of the changes described in the preceding paragraph, the final regulations do not adopt the recommendation to allow a tolling period to remedy the loss of QFPF status. For the same reasons, the final regulations also do not adopt the recommendation to provide an exception to the qualified holder rule for any failure to meet the requirements in §1.897(l)-1(c)(2) or to have the qualified holder rule apply only to USRPIs owned by non-QFPFs when such non-QFPFs are acquired by a QFPF. The section 897(l) exception provides a substantial benefit to investors, and it is appropriate to require an eligible fund to meet the requirements in the final regulations for a ten-year maximum testing period before obtaining tax-free treatment to ensure the exception is not claimed inappropriately. Cf. section 877 (requiring taxpayer to be subject to potential additional U.S. taxation for ten years after relinquishing U.S. citizenship); §§1400Z-2 (allowing taxpayer to receive a step-up in basis of property equal to its fair market value if held for ten years); 1.937-2(f) (requiring individual to be bona fide resident of a territory for 10 years before sale of property is sourced to territory and

receives beneficial tax rate). Accordingly, the final regulations also do not adopt a maximum testing period that is shorter than ten years.

With respect to the suggested alternatives to the qualified holder rule, the preamble to the proposed regulations explained that the mark-to-market and tracing approaches both imposed greater compliance and administrative costs relative to the testing-period approach without providing any accompanying general economic benefit. Even if the investor is given the option to elect a mark-to-market approach, it would still present compliance and administrative barriers because fair market valuations of real property are not readily available. The tracing approach would similarly impose compliance and administrative burdens, as such an approach would require obtaining a fair market valuation of real property when an entity became a QCE, as well as tracking the USRPIs that were acquired before the entity became a QCE so that the pre-acquisition built-in gain could be recognized upon a later disposition. Accordingly, the final regulations do not adopt the mark-to-market or tracing alternatives.

C. Qualified segregated accounts

The proposed regulations provided that a qualified holder is exempt from section 897(a) only with respect to gain or loss that is attributable to one or more qualified segregated accounts maintained by the qualified holder. Prop. §1.897(l)-1(b)(2). The proposed regulations defined a qualified segregated account as an identifiable pool of assets maintained for the sole purpose of funding qualified benefits (that is, retirement, pension, or ancillary benefits) to qualified recipients (generally, plan participants and beneficiaries). See Prop. §1.897(l)-1(d)(13)(i). The proposed regulations provided separate standards for determining whether an identifiable pool of assets is maintained for the sole purpose of funding qualified benefits depending on whether the pool of assets is maintained by an eligible fund (including an eligible fund that satisfies the

requirements to be treated as a QFPP) or a QCE. See Prop. §1.897(l)-1(d)(13)(ii); Prop. §1.897(l)-1(d)(13)(iii).

Comments requested that the final regulations clarify the standards that apply for determining whether an identifiable pool of assets is maintained for the sole purpose of funding qualified benefits, and one comment recommended removing the standards altogether. Specifically, comments identified several situations in which qualified segregated accounts are maintained for the sole purpose of funding qualified benefits to qualified recipients, but where the funds could nevertheless be disbursed for other purposes or to non-qualified recipients. For example, one comment noted that an eligible fund could rebate an overfunded amount by a foreign defined benefit pension fund to an employer. Another comment noted that assets might not be disbursed to qualified recipients or used to pay reasonable plan expenses if a potential change in foreign law impacts how fund assets can be used. One comment highlighted that assets might revert to sponsoring employers if employees cease participating in the plan before their benefits have vested. Another comment cited the possibility that upon a dissolution of the eligible fund, assets could revert to the employer after satisfying its obligations to qualified recipients and creditors. In each such situation, the comments recommended that the final regulations clarify that a pool of assets would not fail to qualify as a qualified segregated account. One comment further recommended that the final regulations eliminate the requirement that all income and assets maintained in a qualified segregated account of an eligible fund be used to fund the provision of qualified benefits to qualified recipients because such a provision is unnecessary to ensure that income and assets of an eligible fund do not inure to inappropriate recipients.

The Treasury Department and the IRS agree that in certain situations the reversion of funds to a governmental unit or an employer, after satisfaction of liabilities

to creditors and qualified recipients, should not disqualify the account from being treated as maintained for the sole purpose of funding qualified benefits to be provided to qualified recipients. Accordingly, the final regulations clarify that a qualified segregated account that is held by an eligible fund is treated as maintained for the sole purpose of funding qualified benefits to be provided to qualified recipients notwithstanding that funds may revert (such as upon dissolution or the benefits failing to vest) to the governmental unit or employer in accordance with applicable foreign law so long as contributions to the plan are not more than what is reasonably necessary to fund the qualified benefits to be provided to qualified recipients. §1.897(l)-1(e)(13)(i). This requirement ensures that a governmental unit or employer does not qualify for benefits under section 897(l) to the extent it inappropriately overfunds the plan.

One comment further recommended that the final regulations treat an eligible fund's interest in a corporation as a qualified segregated account. This recommendation was made to resolve the issue, described in Part I.A.1 of this Summary of Comments and Explanation of Revisions, that arises when multiple foreign government entities, some of which are QFPFs and some of which are not, jointly invest in USRPIs through a foreign partnership that is treated as a per se corporation for U.S. federal tax purposes (pursuant to §301.7701-2(b)(6)), but cannot qualify as a QCE because not all of the investors are QFPFs.

The final regulations do not adopt this recommendation for several reasons. First, the suggestion contemplates a situation that is contrary to the requirement in section 897(l)(1) that requires an entity to be wholly owned by a QFPF in order to qualify for the exception under section 897(l). Thus, the recommendation potentially allows the exemption from taxation under section 897(a) to inure to non-QFPFs. Second, the issue described in the comment ultimately arises because of the rule under §301.7701-2(b)(6) rather than the final regulations, and therefore a modification to the final

regulations is not the appropriate resolution. Third, the recommendation does not ensure that the assets or income of the corporation are used only for the purpose of providing benefits to qualified recipients, a key purpose of the qualified segregated account rules.

II. Comments and Revisions Relating to Requirements Applicable to a QFPF

A. Established to provide retirement and pension benefits

The proposed regulations allowed pension funds established by one or more employers and government-sponsored public pension funds to be considered QFPFs. Specifically, the proposed regulations provided that an eligible fund must be established by either (i) the foreign country in which it is created or organized to provide retirement or pension benefits to participants or beneficiaries that are current or former employees or persons designated by such employees as a result of services rendered by such employees to their employers (“government-established fund”), or (ii) one or more employers to provide retirement or pension benefits to participants or beneficiaries that are current or former employees or persons designated by such employees in consideration for services rendered by such employees to such employers (“employer fund”). Prop. §1.897(l)-1(c)(2)(ii)(A). The language in proposed §1.897(l)-1(c)(2)(ii)(A) generally reflected the statutory language in section 897(l)(2)(B).

1. Pension Funds Eligible for Section 897(l)(2)(B)

a. “Established by” requirement

One comment requested that the final regulations clarify the requirement that an eligible fund be “established by” a foreign government in the case of a government-established fund. The comment expressed concern that the “established by” requirement in the proposed regulations could exclude the national pension systems of certain countries under which accounts in the names of individual participants are maintained by private entities. The comment explained that some foreign countries

have pension systems in which all employees (or employees working in a certain sector of the economy) are required by law to establish a pension account held and managed by a private pension administrator. Although the arrangement is created by government mandate and subject to government regulation, the private pension administrators form the investment vehicles, select the investment advisors, and receive, invest, and disburse the funds. The extent of additional government involvement varies, but could include the government being the conduit through which contributions by employers and employees are funneled into the plans or benefits are disbursed. The comment asserted that such an arrangement should be treated as “established by” the foreign government for purposes of qualifying as a government-established fund and that each private pension administrator, the investment vehicles that it establishes, and any government office that is within the flow of funds should be treated as part of an “arrangement” that maintains qualified segregated accounts. According to the comment, if participation in the pension system is mandatory, a foreign government should meet the “established by” requirement for a government-established fund even if the government does not actually receive contributions and disburse benefits or hold or invest the funds. The comment recommended that the final regulations clarify that an arrangement created pursuant to a foreign government mandate, but in which private investment managers hold and invest contributions, should be treated as “established by” the foreign government.

The Treasury Department and the IRS recognize that eligible funds in foreign countries may be established and administered in numerous ways. The Treasury Department and the IRS also continue to believe that the purpose of section 897(l) is best served by permitting a broad range of structures to be treated as a QFPP. Accordingly, the final regulations clarify that an eligible fund may be established by, or at the direction of, a foreign jurisdiction for purposes of qualifying as a government-

established fund. §1.897(l)-1(c)(2)(ii)(A)(1)(i). If an eligible fund is established at the direction of a foreign jurisdiction to provide benefits to the establishing entity's employees in consideration for services rendered to the establishing entity, the final regulations clarify that the fund will be considered an employer fund only. §1.897(l)-1(c)(2)(ii)(A)(2). Finally, the final regulations clarify that an eligible fund is treated as being established by a foreign jurisdiction or an employer notwithstanding that one or more persons that are not the foreign jurisdiction or employer administers the eligible fund. §1.897(l)-1(c)(2)(ii)(A)(3). Thus, an arrangement created pursuant to a foreign government mandate in which private investment managers hold and invest contributions is treated as "established by" the foreign government.

b. Employer fund established by foreign government

One comment indicated that, under the proposed regulations, it was not clear that a QFPF could include pension arrangements established by governmental units in their function as employers, while also noting that such funds could potentially qualify as both a government-established fund and an employer fund. The comment recommended clarifying that an otherwise qualifying pension fund can be established by government employers.

The final regulations clarify that an eligible fund can be established by a governmental unit acting in its capacity as an employer, and specify that such a fund constitutes an employer fund. §1.897(l)-1(c)(2)(ii)(A).

2. Purpose of Eligible Fund

Proposed §1.897(l)-1(c)(2)(ii)(B) required that all of the benefits that an eligible fund provides are qualified benefits to qualified recipients (the "100 percent threshold"), and that at least 85 percent of the present value of the qualified benefits that the eligible fund reasonably expects to provide in the future are retirement or pension benefits (the "85 percent threshold"). For this purpose, qualified benefits were defined as retirement,

pension, or ancillary benefits. Prop. §1.897(l)-1(d)(8). As discussed in the preamble to the proposed regulations, the Treasury Department and the IRS adopted the 85 percent threshold because it was more administrable and provided more certainty to taxpayers than a subjective standard. The preamble to the proposed regulations indicated that the calculation of the 85 percent threshold would be made on an annual basis, but the proposed regulations did not explicitly identify a period for making this determination.

a. Comments received

Several comments stated that a strict numerical threshold created a cliff effect and caused uncertainty as to whether an eligible fund would qualify as a QFPF on a consistent basis over several years. Particular concern was expressed by one comment that an annual test may cause disqualification as a QFPF for reasons not entirely within the eligible fund's control, such as when the population of qualified recipients changes. Other comments stated that the present value calculation in the proposed regulations was vague, and one comment stated that the proposed regulations did not clearly identify the frequency with which the reasonable expectation of present value should be calculated.

Based on these observations, several comments suggested that the objective 85 percent threshold should be replaced with a subjective test assessing the fund's purpose. These comments suggested that instead of the 85 percent threshold, a fund's purpose should be determined, considering all the facts and circumstances, by assessing whether the fund was established to provide retirement and pension benefits. Comments also suggested that the 85 percent threshold could be used as a safe harbor; a fund that does not meet that requirement would then have to show that it was established to provide retirement and pension benefits given all the facts and circumstances. One comment suggested another safe harbor whereby any fund that did not meet the 85 percent threshold could still qualify as a QFPF on a proportionate

basis by comparing the present value of the retirement and pension benefits the fund reasonably expects to pay to the present value of all benefits it reasonably expects to pay.

Several comments stated that if the 85 percent threshold were retained, the final regulations should provide guidance on the assumptions that may be made in making the present value calculation, including the frequency of the calculation. One comment suggested that forecasts of anticipated future benefits that are already prepared by the eligible fund should be considered reasonable if they are based on data that the fund prepares for general business purposes in accordance with internal procedures. Another comment suggested that reasonable actuarial standards applied in good faith could be a basis for this calculation.

In addition, several comments requested that the final regulations provide relief if a fund does not qualify as a QFPF in a particular year. These comments suggested that a look-back rule allow eligible funds to calculate compliance with the 85 percent threshold over a multi-year period, such as three years, rather than on an annual basis. One comment suggested other alternatives, such as providing a grace period during which a fund could regain compliance as a QFPF without losing its exempt status or the granting of proportionate eligibility as a QFPF.

b. 85 percent threshold

The Treasury Department and the IRS continue to believe that the 85 percent threshold is more administrable and provides more certainty than a subjective standard for determining whether an eligible fund is established to provide retirement and pension benefits. The Treasury Department and the IRS also continue to believe that this threshold allows an appropriate margin for nonconforming benefits. Accordingly, the final regulations retain the 100 percent threshold and 85 percent threshold, and do not adopt a subjective standard. §1.897(l)-1(c)(2)(ii)(B). However, several other

comments suggesting further clarity or relief with respect to the 85 percent threshold are incorporated in the final regulations, as described in paragraphs II.A.2.c. and II.A.2.d. of this Summary of Comments and Explanation of Revisions.

c. Clarifications regarding present valuation

The Treasury Department and the IRS believe that further guidance with respect to determining the present value of benefits that an eligible fund reasonably expects to provide is appropriate. To clarify what this calculation is intended to value, the final regulations state that the eligible fund must measure the present value of benefits to be provided during the entire period during which the fund is expected to be in existence. §1.897(l)-1(c)(2)(ii)(C)(1). Comments articulated different, though potentially overlapping, benchmarks for determining what valuation methods would be considered reasonable—for example, making the determination based on data prepared for general business purposes in accordance with internal procedures or based on actuarial standards applied in good faith. As a result, the Treasury Department and the IRS have decided to use a broad standard that would accommodate all such suggestions by providing that an eligible fund may utilize any reasonable method for determining present value. *Id.* Although the final regulations are intended to provide flexibility as to the method used for determining present value, the Commissioner may determine that the present valuation requirement is not satisfied if the relevant facts and circumstances indicate that the method used was unreasonable (for example, it may be relevant that the method used results in a percentage calculation of retirement and pension benefits that differs materially from the actual percentage of the retirement and pension benefits provided before the most recent present valuation date). See also §1.897(l)-1(c)(3)(iii) for the requirement that an eligible fund maintain records to show it meets the requirements of §1.897(l)-1(c)(2), which is discussed in Part III.B. of this Summary of Comments and Explanation of Revisions.

The Treasury Department and the IRS believe that further guidance is also appropriate with respect to the frequency with which the valuation needs to be made. The final regulations state that such a determination must be made on at least an annual basis. §1.897(l)-1(c)(2)(ii)(C)(1). Thus, for example, if an eligible fund changes its taxable year and has a short taxable year, the eligible fund may make its present value determination for the short taxable year provided that it makes another present value determination within one year. Consistent with the above, the final regulations clarify that an eligible fund must use its most recent present value determination (or its most recent 48-month alternative calculation, described in Part II. A.2.d. of this Summary of Comments and Explanation of Revisions) with respect to dispositions of USRPIs or distributions described in section 897(h) that occur during the twelve months that succeed such present value determination (or 48-month alternative calculation), or until a new present value determination is made, whichever occurs first. §1.897(l)-1(c)(2)(ii)(C)(3).

d. 48-month average alternative

Finally, the Treasury Department and the IRS agree that because unanticipated events may cause a fund to fail the 85 percent threshold in any one year, the fund should still qualify as a QFPI if it shows that it has consistently qualified as such over an extended period. The final regulations therefore adopt a 48-month alternative calculation test as another means to satisfy the 85 percent threshold. §1.897(l)-1(c)(2)(ii)(C)(2). The 48-month alternative calculation test is satisfied if the average of the present values of the retirement and pension benefits the eligible fund reasonably expected to provide over its life, as determined by the valuations performed over the 48 months preceding (and including) the most recent present valuation, satisfies the 85

percent threshold.² The determination of such average is based on the values (not percentages) of the qualified benefits the eligible fund reasonably expected to provide. In addition, the 48-month alternative calculation must be determined using a weighted average whereby values are adjusted, if necessary, when the length of valuation periods differs.³ If an eligible fund has been in existence for less than 48 months, the 48-month alternative calculation is applied to the period the eligible fund has been in existence. The 48-month alternative calculation may be satisfied based on any reasonable determination of the present valuation for any period that starts before the date that the valuation requirements first apply to an organization or arrangement and ends on or before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

While the comments and related changes to the final regulations described above apply to the 85 percent threshold, similar rules have also been added for consistency with respect to the new category of non-ancillary benefits added to the final regulations and further described in Part II.A.3.b of this Summary of Comments and Explanation of Revisions.

3. Qualified Benefits

a. Retirement and pension benefits

The proposed regulations did not provide a definition of retirement and pension benefits. Rather, in the preamble to the proposed regulations, the Treasury Department and the IRS requested comments on whether the regulations should define retirement

² The Commissioner may determine that the 48-month alternative calculation is not satisfied if, as discussed in Part II.A.2.c of this Summary of Comments and Explanation of Revisions, the relevant facts and circumstances indicate that the method used to determine present value was unreasonable.

³ The length of the valuation periods may differ if the eligible fund performs valuations more than once a year.

and pension benefits (for example, with reference to whether there are penalties for early withdrawals).

Although one comment suggested that the term retirement and pension benefits was clear and did not require a definition, most comments requested that the final regulations provide a definition of retirement and pension benefits. Comments recommended several sources that the final regulations might refer to in defining retirement and pension benefits, including the Employee Retirement Income Security Act of 1974 (“ERISA”), U.S. federal income tax law principles (for example, Chapter 1, Subchapter D of the Code and corresponding Treasury Regulations), and income tax treaties. One comment suggested that the final regulations provide separate definitions of retirement and pension benefits based in part on these sources of U.S. tax law. This comment generally proposed defining retirement benefits as those benefits that are paid after reaching a predetermined retirement age that are provided in return for services rendered or contributions made. The comment generally proposed defining pension benefits as those benefits paid after the participant retires due to a proven disability before having reached a predetermined retirement age or paid to surviving beneficiaries if the participant dies before reaching the predetermined retirement age and that are provided in return for services rendered or contributions made.

In response to these comments and to provide greater clarity, the final regulations provide a definition of retirement and pension benefits. Furthermore, the final regulations adopt a broad definition of retirement and pension benefits to ensure that a wide variety of pension funds and foreign laws are accommodated. Thus, the final regulations provide that retirement and pension benefits mean benefits payable to qualified recipients after reaching retirement age under the terms of the eligible fund, or after an event in which the eligible fund recognizes that a qualified recipient is permanently unable to work, and including any such distribution made to a surviving

beneficiary of the qualified recipient. §1.897(l)-1(e)(14). The inclusion of payments of accrued benefits after a specified event that results in a permanent disability (such that the qualified recipient is unable to work) or survivor benefits in the definition of retirement and pension benefits is intended to resolve concerns expressed in comments regarding the potential overlap of such benefits with the benefits listed in the definition of ancillary benefits in proposed §1.897(l)-1(d)(1) (for example, the proposed definition of ancillary benefits included death and disability benefits). To provide additional clarity regarding the factors that would indicate whether a benefit is a retirement and pension benefit, as well as the distinction between retirement and pension benefits and ancillary benefits, the final regulations also provide that retirement and pension benefits are generally based on contributions and investment performance, as well as factors such as years of service with an employer and compensation received by the qualified recipient. *Id.* The final regulations do not require retirement and pension benefits to be paid in a particular manner (that is, an annuity versus a lump-sum).

b. Ancillary and non-ancillary benefits

The proposed regulations defined ancillary benefits to mean benefits payable upon the diagnosis of a terminal illness, death benefits, disability benefits, medical benefits, unemployment benefits, or similar benefits. Prop. §1.897(l)-1(d)(1).

As discussed in Part II.A.2 of this Summary of Comments and Explanation of Revisions, numerous comments requested that the final regulations provide clarifications and incorporate flexibility into the definition of ancillary benefits in light of the cliff effect caused by the use of the 100 percent and 85 percent thresholds to determine whether an eligible fund qualifies as a QFPF. Comments highlighted that the funds may be allowed, or required, to provide certain benefits to its participants or beneficiaries that are not enumerated in the definition of ancillary benefits, such as limited withdrawals to fund a first home. Comments expressed concern that the

provision of such a benefit would disqualify the plan from the exemption under section 897(l) because such a benefit is not listed in the definition of ancillary benefits, it is not certain whether such benefit is a “similar benefit,” and the numerical thresholds do not allow for the provision of any benefits other than retirement and pension or ancillary benefits. The comments argued that the provision of such benefits should not disqualify the plan from the exemption under section 897(l) because, generally, the provision of such benefits is not the main purpose of the plan and represents only a small portion of the benefits paid out by the plan.

Comments suggested clarifying the scope of the term “similar benefits” in the definition of ancillary benefits and expanding the definition of ancillary benefits to include any benefits that are allowed or required to be paid under the laws of the foreign jurisdiction in which the fund is created or organized. Comments also argued that a broad category of ancillary or other benefits tied to the benefits allowed under foreign law is needed to accommodate potential changes to the type of benefits allowed under foreign pension regimes. One comment recommended that such a rule also apply where pension plans and non-qualifying plans providing for other types of benefits are required by foreign law to be pooled into one fund or arrangement, which might otherwise preclude an eligible entity from being a QFPF even though it is predominantly a pension fund.

Several comments recommended that the final regulations allow for a fund to provide a de minimis amount of benefits that are neither retirement and pension benefits nor any of the benefits listed under the definition of ancillary benefits in the proposed regulations. One comment recommended permitting a de minimis percentage of the total benefits provided by a fund (for example, up to five percent) to be any benefits that are not retirement and pension benefits or specifically listed in the definition of ancillary benefits, provided the benefits are required or allowed to be paid under the laws of the

foreign jurisdiction where the fund is created or organized. Another comment, citing the broad range of foreign pension arrangements and the lack of clear guidance in certain jurisdictions regarding the potential benefits that can be provided by pension arrangements, suggested a de minimis amount (for example, three percent) of total benefits be allowed for non-ordinary benefits that fall outside the scope of the definition of ancillary benefits.

Several comments also noted that certain of the benefits enumerated in the definition of ancillary benefits in the proposed regulations may be more closely related to the payment of retirement and pension benefits. For example, one comment noted that a participant or beneficiary may be eligible to make withdrawals of their retirement and pension benefits before reaching retirement age upon permanent disability or diagnosis of a terminal illness. These and other types of similar benefits, such as survivor benefits (that is, payments of the beneficiary or participant's retirement and pension benefits to a surviving designee upon the death of the beneficiary or participant), are paid in recognition of past service or because the plan participant is unable to continue working or care for their dependents. In such cases, the benefit is effectively being paid as a retirement and pension benefit, but such benefit could improperly be considered an ancillary benefit under the definition in proposed §1.897(l)-1(d)(1). Another comment similarly noted that ancillary benefits should not refer to annuities payable to surviving beneficiaries or on early retirement because of a disability and suggested that the definition of ancillary benefits be modified to refer only to certain one-time payments made in connection with disability, terminal illness, or death. One comment noted that many benefits that otherwise might be ancillary benefits, such as medical and disability benefits, are often available principally to retirees. Thus, comments recommended that the definition of ancillary benefits be clarified such that

benefits that are more appropriately characterized as retirement and pension benefits are not inappropriately treated as ancillary benefits.

In response to the comments, the final regulations provide additional clarity with respect to the types of benefits permitted to be provided by a QFPF.

First, as discussed in Part II.A.3.a of this Summary of Comments and Explanation of Revisions, the final regulations provide a definition of retirement and pension benefits, which is intended to clarify that certain benefits that may have potentially been categorized as ancillary benefits under the proposed regulations are retirement and pension benefits. This definition should assist in distinguishing retirement and pension benefits from ancillary benefits and, because more benefits should be characterized as retirement and pension benefits, should lessen the concern that the provision of ancillary benefits will jeopardize qualification as a QFPF.

Second, the final regulations modify the definition of ancillary benefits by providing a more detailed list of specific types of benefits that meet the ancillary benefits definition. §1.897(l)-1(e)(1). The revised definition clarifies that, in addition to benefits payable upon the diagnosis of a terminal illness, medical benefits, or unemployment benefits, ancillary benefits also include incidental death benefits (for example, funeral expenses), short-term disability benefits, life insurance benefits, and shutdown or layoff benefits. To distinguish between unemployment, shutdown, or layoff benefits that might also be considered retirement and pension benefits, the final regulations state that those types of benefits will be considered ancillary benefits only if they do not continue past retirement age and do not affect the payment of accrued retirement and pension benefits. §1.897(l)-1(e)(1)(i)(B). In addition, the final regulations clarify what benefits are considered similar to the specifically identified ancillary benefits by indicating that such similar benefits should also be either health-related or unemployment benefits. §1.897(l)-1(e)(1)(i)(C). Lastly, for the avoidance of doubt, the final regulations resolve

any potential overlap between the definitions of retirement and pension benefits and ancillary benefits by providing that if any benefits fall within both definitions, they are only considered to be retirement and pension benefits. §1.897(l)-1(e)(1)(ii). The Treasury Department and the IRS intend for this rule to have limited application given the definitions of retirement and pension benefits and ancillary benefits provided in the final regulations.

Third, the Treasury Department and the IRS have determined that it is appropriate to permit a limited amount of benefits that are outside the scope of retirement and pension benefits and ancillary benefits. The final regulations therefore allow an eligible fund to provide a limited amount of non-ancillary benefits, which the final regulations define as any benefits provided by the eligible fund as permitted or required under the laws of the foreign jurisdiction in which the fund is established or operates that do not otherwise fall within the definition of retirement and pension benefits or ancillary benefits. §1.897(l)-1(e)(6). The final regulations provide that no more than five percent of the present value of the qualified benefits the eligible fund reasonably expects to provide to qualified recipients during the entire period during which the eligible fund is expected to be in existence can be non-ancillary benefits. §1.897(l)-1(c)(2)(ii)(B)(3). This measurement of non-ancillary benefits is determined under the same rules that apply to the present valuation of retirement and pension benefits for purposes of the 85 percent threshold, which are described in Part II.A.2 of this Summary of Comments and Explanation of Revisions.

The final regulations incorporate the allowance for non-ancillary benefits into the 100 percent threshold by revising the definition of “qualified benefits” in the proposed regulations. Specifically, non-ancillary benefits and ancillary benefits, together with the new definition of retirement and pension benefits, comprise the “qualified benefits” that an eligible fund must provide to meet the 100 percent threshold. §1.897(l)-1(e)(8).

c. Other distributions and early withdrawals

The proposed regulations did not explicitly address how early withdrawals from a QFPF should be treated for purposes of determining the amount of retirement or other benefits paid by the QFPF. Specifically, the proposed regulations did not discuss how to treat withdrawals made from one retirement plan and rolled over into a different retirement plan, early withdrawals that certain plans may permit in accordance with country-specific laws, or loans made by an eligible fund. One comment suggested that rollover distributions should not be considered as benefits paid by a plan and thus should be excluded when determining an eligible fund's eligibility as a QFPF. The comment also recommended that in-service plan withdrawals or loans should not be taken into account in calculating the benefits paid by an eligible fund provided that in-service withdrawals before retirement age are permissible under the plan terms or relevant law.

The Treasury Department and the IRS have considered these recommendations and generally agree that the types of withdrawals described above should not be taken into account when calculating the 100 percent threshold, the 85 percent threshold, or the limitation on non-ancillary benefits. As a result, the final regulations add three categories of distributions that are excluded when making these determinations.

§1.897(l)-1(c)(2)(ii)(D).

The first category is a loan to a qualified recipient pursuant to terms set by the eligible fund. Because there is an expectation of repayment, these types of loans should not be included when making threshold benefit determinations. This category, however, excludes a loan that a qualified recipient is not required to repay, in full or in part, upon default (which would generally constitute the provision of a non-ancillary benefit), unless such a default is subject to tax and penalty in a foreign jurisdiction.

The second category is a distribution permitted under the laws of the foreign jurisdiction in which the eligible fund is established or operates and made before the participant or beneficiary reaches the retirement age as determined under relevant foreign laws, but only if the distribution is to a qualified holder or other retirement or pension arrangement subject to similar distribution or tax rules under the laws of the foreign jurisdiction. Such rollover distributions are simply shifting funds between one eligible fund and another similar fund (even if such fund does not qualify as a QFPF) and thus should also be excluded when making the 100 percent and 85 percent threshold determinations.

The third category is a withdrawal of funds before the participant or beneficiary reaches retirement age to satisfy a financial need under principles similar to the U.S. hardship distribution rules permitted under the laws of the foreign jurisdiction in which the eligible fund is established or operates, provided the distribution (or at least the portion of the distribution exceeding basis) is subject to tax and penalty in such foreign jurisdiction. Because the qualified recipient bears some or all of the financial burden with regard to such hardship withdrawals, they are excluded when making threshold benefit determinations.

4. Qualified Recipient

Proposed §1.897(l)-1(c)(2)(ii)(B)(1) required that all the benefits that an eligible fund provides be qualified benefits to qualified recipients. With respect to a government-established fund, proposed §1.897(l)-1(d)(12)(i)(A) defined a qualified recipient as any person eligible to be treated as a participant or beneficiary of such eligible fund and any person designated by such person to receive qualified benefits. Thus, the determination of whether a person was a qualified recipient of a government-established fund was made without regard to an individual's status as a current or former employee. With respect to an employer fund, proposed §1.897(l)-1(d)(12)(i)(B)

defined a qualified recipient as a current or former employee or any person designated by such current or former employee to receive qualified benefits.

Several comments stated that the proposed regulations were too restrictive because they did not allow for the possible participation of individuals in an employer fund if they were neither current nor former employees, as allowed in some countries. The comments noted, however, that individuals who have never been employees represent only a minority of members in any fund. One comment suggested that the definition of qualified recipient be expanded accordingly to include any individual allowed to participate in an eligible fund under the laws of the foreign jurisdiction in which the fund is created or organized. Another comment requested that the definition of qualified recipient include a de minimis threshold for members of an eligible fund that are neither current nor former employees. For example, an eligible fund could qualify for the section 897(l) exemption (assuming all other requirements were met) if more than 70 percent of its members were current or former employees measured annually. The comment also recommended that spouses of eligible participants or beneficiaries should be explicitly identified as qualified recipients as defined in proposed §1.897(l)-1(d)(12).

Another comment stated that, as to government-established funds, the term qualified recipient could potentially be read as encompassing a broad group of participants in other types of government programs beyond just pension funds. The comment requested that the final regulations make explicit that a recipient (or person designating the recipient) must both have been employed and be receiving benefits by reason of his or her employment. Finally, one comment noted that the proposed regulations appropriately treated a self-employed individual as both an employer and an employee. Prop. §1.897(l)-1(c)(2)(ii)(C). The comment requested that proposed §1.897(l)-1(e), example 1, be altered to clarify that the retirement benefits provided

under the facts of the example were provided as a result of citizens' services as employed or self-employed individuals.

The Treasury Department and the IRS agree that the proposed regulations may unnecessarily restrict arrangements, permitted in certain countries, that allow for the participation of individuals who were never employees in an employer fund. Further, the Treasury Department and the IRS understand that such individuals represent only a minority of members in any fund. The Treasury Department and the IRS believe that unlimited or significant participation by individuals who were never employees or their designees would be inappropriate. The final regulations therefore allow individuals who were never employees to constitute up to five percent of participants in plans established by employers (and therefore to be treated as qualified recipients).

§1.897(l)-1(e)(12)(i)(C). The final regulations also include spouses of current or former employees in the definition of qualified recipients. §1.897(l)-1(e)(12)(i)(B).

The Treasury Department and the IRS do not believe that further changes are necessary to (1) make explicit that a qualified recipient (or person designating the recipient) with respect to a government-established fund must both have been employed and be receiving benefits by reason of his or her employment, or (2) to modify proposed §1.897(l)-1(e), example 1, to state that the retirement and pension benefits provided by the government-established fund were provided as a result of citizens' services as employed or self-employed individuals. As provided in the proposed regulations, a government-established fund must be established to provide retirement or pension benefits to participants or beneficiaries that are current or former employees or persons designated by such employees as a result of services rendered by such employees to their employers, but may include participants on a basis broader than an employee relationship. The comments seeking to narrow the scope of qualified recipients for government-established funds are inconsistent with the request to

broaden the definition of a qualified recipient with respect to an employer fund to include (within limits) individuals who were never employees. At the same time, the Treasury Department and the IRS believe that an explicit connection between the work of an employee and the qualified benefits provided by an eligible fund is reflected in the final regulations through the definition of a government-established fund, as well as the requirement that all eligible funds must reasonably expect to provide 85 percent retirement and pension benefits, which are defined in the final regulations at §1.897(l)-1(e)(14). These requirements provide an appropriate safeguard to ensure that government programs other than retirement and pension programs do not form the basis for exemption from tax under section 897(l). Finally, the Treasury Department and the IRS believe that the rule reflected in §1.897(l)-1(c)(2)(ii)(E)(1) (previously at proposed §1.897(l)-1(c)(2)(ii)(C)(1)), which explicitly states that a self-employed individual is considered both an employer and employee, makes adding a reference to self-employed individuals in proposed §1.897(l)-1(e), example 1, unnecessary.

B. Regulation and information reporting

The proposed regulations provided that an eligible fund satisfies the information reporting requirement in section 897(l)(2)(D) only if the eligible fund annually provides to the relevant tax authorities in the foreign country in which the fund is established or operates the amount of qualified benefits provided to each qualified recipient by the eligible fund (if any), or such information is otherwise available to those authorities.

Prop. §1.897(l)-1(c)(iv)(B). An eligible fund is not treated as failing to satisfy such requirement if the eligible fund is not required to provide information to the relevant tax authorities in a year in which no qualified benefits are provided to qualified recipients.

Id. An eligible fund is also treated as satisfying the information reporting requirement in section 897(l)(2)(D) only if the eligible fund is required to provide the information

required by proposed §1.897(l)-1(c)(iv)(B), or such information is otherwise available, to one or more governmental units. Prop. §1.897(l)-1(c)(iv)(C).

One comment highlighted that the rules in the proposed regulations are inadvertently inconsistent when an eligible fund is required by foreign law to provide information to a governmental unit (satisfying proposed §1.897(l)-1(c)(iv)(C)), but does not actually provide such information (not fulfilling proposed §1.897(l)-1(c)(iv)(B)), and requested that the final regulations clarify how these provisions are intended to work.

Proposed §1.897(l)-1(c)(iv)(B) and proposed §1.897(l)-1(c)(iv)(C) were not intended to function as two separate conditions that were required to be met. Rather, the provisions were intended to provide flexibility to eligible funds that provided the relevant information to tax authorities or other governmental units. To clarify this intent, the final regulations combine the two separate provisions into a single provision (§1.897(l)-1(c)(iv)(A)). Thus, the information reporting requirement in section 897(l)(2)(D) is satisfied if a fund annually provides information about the amount of qualified benefits provided to qualified recipients to the relevant tax authorities or other relevant governmental units, or such information is otherwise available to the relevant tax authorities or other relevant governmental units. §1.897(l)-1(c)(iv)(A). A fund will not fail to satisfy such requirement if it is not required to provide information to the relevant tax authorities or other relevant governmental units in a year in which no qualified benefits are provided to qualified recipients. Id.

C. Subnational tax regime

For purposes of the requirement that a QFPF be subject to preferential tax treatment, the proposed regulations provided that, for purposes of section 897(l)(2)(E), references to a foreign country do not include references to a state, province, or political subdivision of a foreign country. The preamble to the proposed regulations explained that subnational taxes generally constitute a minor component of an entity's overall tax

burden in a foreign jurisdiction and therefore should not satisfy the requirement of section 897(l)(2)(E) when such preference had only a minimal impact on reducing the fund's overall tax burden.

Upon further consideration, the Treasury Department and the IRS have determined that, to the extent the subnational tax law is covered under an income tax treaty with the United States, it should constitute a sufficient component of the foreign jurisdiction's taxation regime to be able to satisfy the requirement of section 897(l)(2)(E). Accordingly, the final regulations maintain the approach that subnational taxes generally do not satisfy the requirement of section 897(l)(2)(E), but provide that those taxes can satisfy the requirement of section 897(l)(2)(E) if they are covered taxes under an income tax treaty between that foreign jurisdiction and the United States. See §1.897(l)-1(c)(2)(v)(E).

III. Other Comments and Revisions

A. Withholding rules

1. Withholding on foreign partnerships

Comments requested that the final regulations allow QFPFs that hold interests in USRPIs through foreign partnerships, which are not qualified holders under proposed §1.897(l)-1(d)(11) because they cannot be QCEs, to avoid withholding by providing a certification of non-foreign status (including on a Form W-8EXP). The comments highlighted the difference in withholding when a QFPF invests through a foreign partnership, which would result in withholding (even if the foreign partnership was wholly owned by QFPFs), as opposed to through a foreign corporation that constitutes a QCE or a domestic partnership, neither of which would result in withholding under section 1445. One comment recommended that, for purposes of withholding under section 1445, the final regulations should implement rules similar to the regulations that implement the withholding regime under section 1446(f), which includes a form of look-

through rule. Another comment recommended that the final regulations provide that a foreign partnership that is wholly owned by QFPFs either be treated as a QCE, and therefore a qualified holder, or otherwise be excluded from the definition of a foreign person under section 1445 such that a foreign partnership could certify its non-foreign status to a transferee.

The Treasury Department and the IRS agree that a foreign partnership that is held entirely by qualified holders should not be subject to withholding under section 1445 because the ultimate owners should qualify in full for the exemption under section 897(l). Accordingly, the final regulations provide that a qualified holder (under §1.897(l)-1(d)) and a foreign partnership all of the interests of which are held by qualified holders, including through one or more partnerships, may certify its status as a withholding qualified holder that is not treated as a foreign person for purposes of withholding under section 1445 (and section 1446, as relevant). §1.1445-1(g)(11). To the extent any non-qualified holders hold interests in a foreign partnership, such foreign partnership does not qualify as a withholding qualified holder. However, qualified holders who hold interests in USRPIs through a foreign partnership that is not a withholding qualified holder would still be eligible for the section 897(l) exemption on their distributive share of FIRPTA gains. Under the existing regulations in §1.1445-3, a transferor may, in appropriate cases, reduce withholding by obtaining a withholding certificate from the IRS.

2. Documentation requirements

The proposed regulations permitted a qualified holder to certify that it is exempt from withholding under section 1445 by providing a certification of non-foreign status. The proposed regulations also stated that the IRS intended to revise Form W-8EXP, “Certificate of Foreign Government or Other Foreign Organization for United States Tax Withholding or Reporting,” to permit qualified holders to be exempt from withholding

under section 1445 by establishing their status under section 897(l). Prop. §§1.1445-2(b)(2), 1.1445-2(b)(v), 1.1445-5(b)(3)(ii), and 1.1445-8(e).

Under the final regulations, a withholding qualified holder may submit a certification of non-foreign status to establish withholding qualified holder status for purposes of section 1445(a) pursuant to §1.1445-2(b)(2)(i), with certain modifications. Specifically, the requirements under §1.1445-2(b)(2)(i) are modified to require the transferor to state that it is not treated as a foreign person because it is a withholding qualified holder, and to permit the transferor to provide its foreign taxpayer identification number if it does not have a U.S. taxpayer identification number. The final regulations also clarify that a Form W-8EXP is a type of certification of non-foreign status within the meaning of §1.1445-2(b)(2)(i). Accordingly, the Form W-8EXP is subject to the general rules pertaining to certifications of non-foreign status, such as the period for retaining the certification in §1.1445-2(b)(3) and the rules pertaining to liability of agents in §1.1445-4. Because the final regulations require a transferor to represent its status as a withholding qualified holder on the certification of non-foreign status, the final regulations do not permit a transferor to submit a Form W-9, “Request for Taxpayer Identification Number and Certification,” to establish its status as a withholding qualified holder. See §1.1445-2(b)(2)(vi). Before the release of revised Form W-8EXP, a certification of non-foreign status described in §1.1445-2(b)(2)(i) (but not a Form W-9) should be used by a transferor to establish its status as a withholding qualified holder for purposes of section 1445. Once revised, a withholding qualified holder may certify its non-foreign status with either a certification of non-foreign status described in §1.1445-2(b)(2)(i) (but not a Form W-9) or a Form W-8EXP.

The final regulations provide similar rules for certifications of non-foreign status that establish withholding qualified holder status for purposes of section 1445(e) withholding. See §§1.1445-5(b)(3)(ii) and 1.1445-8(e).

3. Coordination with 1441 and 1442

The proposed regulations provided that distributions made by a United States real property holding company (“USRPHC”) or qualified investment entity (“QIE”) to a qualified holder are not subject to the coordination rules under §1.1441-3(c)(4) and are instead subject only to the requirements of section 1441. Prop. §1.1441-3(c)(4)(iii). Because a qualified holder is treated as a foreign person for purposes of section 1441, but not for purposes of 1445, the proposed rule was intended to subject a distribution to a qualified holder exclusively to the rules in section 1441 to determine if withholding applies.

The Treasury Department and the IRS have determined that, for greater clarity, certain changes should be made to proposed §1.1441-3(c)(4) to reach the result intended by the proposed regulations. Rather than provide that the coordination rules under §1.1441-3(c)(4) do not apply to qualified holders, the final regulations amend the coordination rules to provide that withholding qualified holders are not subject to section 1445 on distributions from USRPHCs that are not treated as dividends (for example, a distribution that is treated as gain from the sale or exchange of property under section 301(c)(3)) and on distributions from REITs or other QIEs that are capital gain dividends that are treated as gain attributable to the sale or exchange of USRPIs. §1.1441-3(c)(4)(i)(B)(2), §1.1441-3(c)(4)(i)(C). Dividends from USRPHCs and dividends from REITs or other QIEs that are not capital gain dividends continue to be subject to withholding under section 1441. §1.1441-3(c)(4)(i)(A), §1.1441-3(c)(4)(i)(C). Section 1.1441-3(c)(4)(i) is also clarified to provide that a USRPHC (other than a REIT or other QIE) satisfies its obligations under sections 1441 and 1445 by following either §1.1441-3(c)(4)(i)(A) or §1.1441-3(c)(4)(i)(B), but a USRPHC that is a REIT or other QIE must follow the coordination provision in §1.1441-3(c)(4)(i)(C). The final regulations also clarify that, to the extent a capital gain dividend from a REIT or other QIE is excluded

from withholding under section 1445 because it is made with respect to stock that is regularly traded on an established securities market in the United States to an individual or corporation that did not own more than 5 percent of the stock (see the second sentence of section 897(h)(1)), withholding will apply under section 1441. See sections 852(b)(3)(E) and 857(b)(3)(E); §1.1441-3(c)(4)(i)(C).

B. Additional requests regarding qualification under section 897(l) and recordkeeping

Comments recommended that the Treasury Department and the IRS allow foreign entities that believe they are QFPFs or QCEs to apply for letter rulings on their qualifications under section 897(l). While the comment acknowledged the need for administrable standards, it noted that, in light of the wide range of possible arrangements under foreign law, certain funds that a “reasonable observer” would consider a QFPF could be excluded. Another comment recommended that the Treasury Department and the IRS adopt a “white list” regime (similar to the United Kingdom’s Qualifying Recognized Overseas Pension Scheme) whereby pension plan regimes regulated in a list of countries could automatically be treated as QFPFs or be subject to a reduced set of qualifying requirements.

The final regulations do not adopt either of these recommendations. The Treasury Department and the IRS do not believe that a private letter ruling program specific to QFPF qualification or a “white list” regime is necessary, as the final regulations provide flexible standards such that a wide variety of funds can constitute eligible funds.

Another comment requested that the final regulations provide that, to the extent life insurance companies or other investment companies hold and invest assets of one or more QFPFs, those life insurance companies or investment companies themselves should qualify as QFPFs. To qualify as a QFPF, an eligible fund must satisfy all of the requirements in §1.897(l)-1(c)(2), and the final regulations do not adopt any special rule

for life insurance companies or investment companies, including whether such assets are held as part of an arrangement comprising a QFPF.

In addition, the final regulations require an eligible fund to maintain records consistent with section 6001 to show that it is eligible for the exemption under section 897(l) and which the Commissioner may request upon examination. The recordkeeping requirement is consistent with general recordkeeping requirements for U.S. taxpayers and is appropriate in light of the flexible standards provided in the final regulations.

C. Clarification with respect to the applicability of the section 897(l) regulations

These regulations reflect the particular policies and objectives underlying section 897(l) (as opposed to other areas of tax law that relate to pension funds). To clarify this, §1.897(l)-1(a) provides that the definitions and requirements in §1.897(l)-1 apply only for purposes of the regulations themselves, including applicable cross-references from other sections, and that no inference is to be drawn with respect to the definitions and requirements in §1.897(l)-1, including with respect to the meaning of a pension fund, for any other purpose.

IV. Applicability Dates

The final regulations apply with respect to dispositions of USRPIs and distributions described in section 897(h) occurring on or after **[INSERT DATE OF PUBLICATION IN FEDERAL REGISTER]**. However, in accordance with the applicability date incorporated in §1.897(l)-1(g)(2), the rule in §1.897(l)-1(b)(1), the qualified holder rule in §1.897(l)-1(d) (previously proposed §1.897(l)-1(d)(11)), as well as the definitions of governmental unit (§1.897(l)-1(e)(5)) and QCE (§1.897(l)-1(e)(9)) apply with respect to dispositions of USRPIs and distributions described in section 897(h) occurring on or after June 6, 2019, the date the proposed regulations were filed with the **Federal Register**. See section 7805(b)(1)(B). An eligible fund may choose to apply the final regulations with respect to dispositions and distributions occurring on or

after December 18, 2015, and before the applicability date of the final regulations, if the eligible fund, and all persons bearing a relationship to the eligible fund described in section 267(b) or 707(b), consistently apply the rules in the final regulations in their entirety for all relevant years. An eligible fund that chooses to apply the final regulations before their applicability date must apply the principles of §1.897(l)-1(d)(4)(i) to any valuation requirements with respect to dates preceding December 18, 2015.

Special Analyses

I. Regulatory Planning and Review -- Economic Analysis

These regulations are not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations.

II. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act, 44 U.S.C. 3501 et seq. (“PRA”), information collection requirements contained in these final regulations are in §§1.1441-3, 1.1445-2, 1.1445-5, 1.1445-8, and 1.1446-1. These collections of information retain the collections of information in the proposed regulations, with a refinement to §1.1441-3(c)(4) to clarify that the portions of distributions made by a USRPHC or QIE to a withholding qualified holder (as defined in §1.1445-1(g)(11)) that are attributable to the disposition of USRPIs are not subject to section 1445 and that the portions of distributions made by a USRPHC or QIE to a withholding qualified holder that are not attributable to the disposition of a USRPI are subject to section 1441. No written comments regarding the information collection requirements were received in response to the solicitation of comments in the proposed regulations.

A. Information collections contained in §1.1441-3(c)(4)(iii)

The final regulations provide that dividends from a USRPHC and dividends from

REITs and other QIEs that are not capital gain dividends to a withholding qualified holder are subject only to the requirements of section 1441. §1.1441-3(c)(4)(i), §1.1441-3(c)(4)(i)(B)(2), §1.1441-3(c)(4)(i)(C). The final regulations further provide that withholding qualified holders are not subject to section 1445 on distributions from USRPHCs that are not treated as dividends (for example, a distribution that is treated as gain from the sale or exchange of property under section 301(c)(3)) and on distributions from REITs or QIEs that are capital gain dividends that are treated as gain attributable to the sale or exchange of USRPIs. §1.1441-3(c)(4)(i)(B)(2), §1.1441-3(c)(4)(i)(C).

A USRPHC or QIE making a distribution to a qualified holder would be required to report the distribution on Form 1042-S, "Foreign Person's U.S. Source Income Subject to Withholding," and file Form 1042, "Annual Withholding Tax Return for U.S. Source Income of Foreign Persons." For purposes of reporting the portion of the distributions that are exempt from section 1445 withholding, the IRS revised Form 1042-S to include an exemption code designating payments that are exempt under section 897(l). No revisions are being made to Form 1042 in connection with payments that are exempt under section 897(l).

For purposes of the PRA, the reporting burden associated with §1.1441-3(c)(4) will be reflected in the PRA submissions for Form 1042 (OMB control numbers 1545-0123 for business filers and 1545-0096 for all other Form 1042 filers) and Form 1042-S (OMB control number 1545-0096).

B. Information collections in §§1.1445-2, 1.1445-5, 1.1445-8, and 1.1446-1

Sections 1.1445-2, 1.1445-5, 1.1445-8, and 1.1446-1 would require a qualified holder wishing to claim an exemption under section 897(l) to provide a withholding agent with either a Form W-8EXP or a certificate of non-foreign status containing similar information to the Form W-8EXP. The IRS plans to revise Form W-8EXP for use by

qualified holders. For purposes of the PRA, the reporting burden associated with §§1.1445-2, 1.1445-5, 1.1445-8, and 1.1446-1, will be reflected in the PRA submission for Form W-8EXP (OMB control number 1545-1621).

The reporting burdens associated with the information collections in the final regulations are included in the aggregate burden estimates for OMB control numbers 1545-0096 (which represents a total estimated burden time for all forms and schedules of 6.46 million hours) and 1545-1621 (which represents a total estimated burden time, including all other related forms and schedules for other filers, of 30.5 million hours).

The overall burden estimates for the OMB control numbers are aggregate amounts that relate to the entire package of forms associated with the applicable OMB control number and will in the future include, but not isolate, the estimated burden of the tax forms that will be or have been revised as a result of the information collections in the final regulations. These numbers are therefore unrelated to the future calculations needed to assess the burden imposed by the final regulations. These burdens have been reported for other regulations related to the taxation of cross-border income, and the Treasury Department and the IRS urge readers to recognize that these numbers are duplicates and to guard against overcounting the burden that international tax provisions impose.

An agency may not conduct or sponsor and a person is not required to respond to a collection of information unless it displays a valid OMB control number.

III. Regulatory Flexibility Act

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that this rulemaking will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act. This certification is based on the fact that the final regulations affect

foreign pension funds, including sovereign funds, which are entities that are created or organized outside of the United States, with no place of business in the United States, and which operate primarily outside of the United States. Accordingly, the entities affected by the final regulations are not considered small entities, and a regulatory flexibility analysis under the Regulatory Flexibility Act is not required.

IV. Section 7805(f)

Pursuant to section 7805(f) of the Code, the proposed regulations (REG-109826-17) preceding these final regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on the impact on small businesses and no comments were received.

V. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of \$100 million in 1995 dollars, updated annually for inflation. The final regulations do not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

VI. Executive Order 13132: Federalism

Executive Order 13132 (entitled “Federalism”) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. The final regulations do not have federalism implications, do not impose substantial direct compliance costs on state and local governments, and do not preempt state law within the meaning of the Executive

order.

Statement of Availability of IRS Documents

IRS Revenue Procedures, Revenue Rulings, Notices, and other guidance cited in this document are published in the Internal Revenue Bulletin or Cumulative Bulletin and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at www.irs.gov.

Drafting Information

The principal authors of these final regulations are Arielle Borsos and Milton Cahn, Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

* * * * *

Section 1.897(l)-1 also issued under 26 U.S.C. 897(l).

* * * * *

Par. 2. Section 1.897(l)-1 is added to read as follows:

§1.897(l)-1 Exception for interests held by foreign pension funds.

(a) Scope and overview. This section provides rules regarding the exception from section 897 for qualified holders. The definitions and requirements in this section apply only for purposes of this section (including as applicable by cross-reference from

other sections), and no inference is to be drawn with respect to the definitions and requirements in this section, including with respect to the meaning of a pension fund, for any other purpose. Paragraph (b) of this section provides the general rule excepting qualified holders from section 897. Paragraph (c) of this section provides the requirements that an eligible fund must satisfy to be treated as a qualified foreign pension fund. Paragraph (d) of this section provides the requirements that a qualified foreign pension fund or a qualified controlled entity must satisfy to be treated as a qualified holder. Paragraph (e) of this section provides definitions. Paragraph (f) of this section provides examples illustrating the application of the rules of this section. Paragraph (g) of this section provides applicability dates. For rules applicable to a qualified foreign pension fund or qualified controlled entity claiming an exemption from withholding under chapter 3, see generally §§1.1441-3, 1.1445-2, 1.1445-5, 1.1445-8, 1.1446-1, and 1.1446-2.

(b) Exception from section 897--(1) In general. Gain or loss of a qualified holder from the disposition of a United States real property interest, including gain from a distribution described in section 897(h), is not subject to section 897(a).

(2) Limitation. Paragraph (b)(1) of this section applies solely with respect to gain or loss that is attributable to one or more qualified segregated accounts maintained by a qualified holder.

(c) Qualified foreign pension fund requirements--(1) In general. An eligible fund is a qualified foreign pension fund if it satisfies the requirements of this paragraph (c). Paragraph (c)(2) of this section provides rules regarding the application of the requirements of section 897(l)(2) to an eligible fund. Paragraph (c)(3) of this section provides rules on the application of the requirements in paragraph (c)(2) of this section, including rules regarding the application of those requirements to an eligible fund that is an organization or arrangement and rules regarding recordkeeping.

(2) Applicable requirements--(i) Created or organized. An eligible fund must be created, organized, or established under the laws of a foreign jurisdiction. For purposes of this paragraph (c)(2)(i), a governmental unit is treated as created or organized in the foreign jurisdiction with respect to which it is, or is a part of, the foreign government.

(ii) Establishment of eligible fund--(A) General requirement--(1) Purpose of and parties establishing eligible fund. An eligible fund must be established --

(i) By, or at the direction of, the foreign jurisdiction in which it is created or organized to provide retirement and pension benefits to participants or beneficiaries that are current or former employees or persons designated by such employees as a result of services rendered by such employees to their employers; or

(ii) By one or more employers (including a governmental unit in its capacity as an employer) to provide retirement and pension benefits to participants or beneficiaries that are current or former employees or persons designated by such employees in consideration for services rendered by such employees to such employers.

(2) Identification of type of eligible fund. An eligible fund that is described in both paragraphs (c)(2)(ii)(A)(1)(i) and (ii) of this section shall be treated solely as described in the latter paragraph.

(3) Role of parties other than the foreign jurisdiction or employer. For purposes of paragraph (c)(2)(ii)(A)(1) of this section, the determination of whether an eligible fund is established by, or at the direction of, a foreign jurisdiction or established by an employer is made without regard to whether one or more persons that are not the foreign jurisdiction or employer administer or otherwise provide services with regard to the eligible fund (including holding assets in a qualified segregated account as part of or on behalf of the eligible fund).

(B) Established to provide retirement or pension benefits. An eligible fund is established to provide retirement or pension benefits for purposes of the general requirement in paragraph (c)(2)(ii)(A) of this section if--

(1) All of the benefits that an eligible fund provides are qualified benefits provided to qualified recipients;

(2) At least 85 percent of the present value of the qualified benefits that the eligible fund reasonably expects to provide to qualified recipients in the future are retirement and pension benefits; and

(3) No more than five percent of the present value of the qualified benefits the eligible fund reasonably expects to provide to qualified recipients in the future are non-ancillary benefits.

(C) Present valuation.--(1) In general. For purposes of satisfying the requirements in paragraphs (c)(2)(ii)(B)(2) and (3) of this section, an eligible fund must determine, on at least an annual basis, the present value of the qualified benefits that the eligible fund reasonably expects to provide to qualified recipients during the entire period during which the eligible fund is expected to be in existence. An eligible fund may utilize any reasonable method for performing the present valuation.

(2) 48-month average alternative calculation. An eligible fund that does not satisfy the requirements of paragraph (c)(2)(ii)(B)(2) or (3) of this section based on the present value determination under paragraph (c)(2)(ii)(C)(1) of this section may satisfy the requirements of paragraph (c)(2)(ii)(B)(2) or (3) of this section based on the alternative calculation in this paragraph (c)(2)(ii)(C)(2). The alternative calculation in this paragraph is satisfied if the average of the present values of the future qualified benefits that the eligible fund reasonably expected to provide, as determined during the 48-month period preceding (and including) the most recent present valuation determination, satisfies the requirements of paragraph (c)(2)(ii)(B)(2) or (3) of this

section, respectively. The determination of such average must be based on the valuations described in paragraph (c)(2)(ii)(C)(1) of this section that were carried out during the 48-month period preceding (and including) the most recent present value determination, and must use the values (not percentages) of the qualified benefits the eligible fund reasonably expected to provide. The determination described in this paragraph must be calculated using a weighted average whereby values are adjusted if the relevant valuations are applicable for different periods (as described in paragraph (c)(2)(ii)(C)(3) of this section) because an eligible fund performs valuations more frequently than on an annual basis. If an eligible fund has been in existence for less than 48 months, this paragraph (c)(2)(ii)(C)(2) is applied to the period that the eligible fund has been in existence. The alternative calculation in this paragraph (c)(2)(ii)(C)(2) may be satisfied based on any reasonable determination of the present valuation described in paragraph (c)(2)(ii)(C)(1) of this section for any period that starts before the date that the requirements of paragraph (c)(2)(ii)(C) of this section first apply to an organization or arrangement and ends on or before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

(3) Application of present valuation. An eligible fund must use the present value determination made as of the most recent valuation under paragraph (c)(2)(ii)(C)(1) of this section or the alternative calculation provided in paragraph (c)(2)(ii)(C)(2) of this section (to the extent the eligible fund did not satisfy the requirements of paragraphs (c)(2)(ii)(B)(2) and (3) of this section in the most recent valuation) for purposes of meeting the requirements in paragraphs (c)(2)(ii)(B)(2) and (3) of this section with respect to dispositions of United States real property interests or distributions described in section 897(h) occurring in the twelve months succeeding the most recent valuation, or until a new present value determination is made, whichever occurs first.

(D) Certain distributions from eligible funds. The following distributions are not taken into account for purposes of determining whether an eligible fund satisfies the requirements of paragraph (c)(2)(ii)(B) of this section--

(1) A loan to a qualified recipient pursuant to terms set by the eligible fund (other than a loan with respect to which a qualified recipient defaults and is not required to repay in whole or part, unless the default is subject to tax and penalty in such foreign jurisdiction);

(2) A distribution (as permitted by the laws of the foreign jurisdiction in which the eligible fund is established or operates) made before the participant or beneficiary reaches the retirement age (as determined under the relevant foreign laws), provided that the distribution is to a designee that is a qualified holder or to another arrangement subject to similar distribution or tax rules under the laws of the foreign jurisdiction; and

(3) A withdrawal of funds before the participant or beneficiary reaches the retirement age (as determined under the relevant foreign laws) to satisfy a financial need (under principles similar to the U.S. hardship distribution rules, see §1.401(k)-1(d)(3)) as permitted under the laws of the foreign jurisdiction in which the eligible fund is established or operates, provided the distribution (or at least the portion of the distribution exceeding basis) is subject to tax and penalty in such foreign jurisdiction.

(E) Certain employers and employees. For purposes of this section, the following rules apply--

(1) A self-employed individual is treated as both an employer and an employee;

(2) Employees of an individual, trust, corporation, or partnership that is a member of an employer group are treated as employees of each member of the employer group that includes the individual, trust, corporation, or partnership; and

(3) An eligible fund established by a trade union, professional association, or similar group, either alone or in combination with the employer or group of employers, is treated as established by any employer that funds, in whole or in part, the eligible fund.

(iii) Single participant or beneficiary--(A) In general. An eligible fund may not have a single qualified recipient that has a right to more than five percent of the assets or income of the eligible fund.

(B) Constructive ownership. For purposes of paragraph (c)(2)(iii)(A) of this section, an individual is considered to have a right to the assets or income of an eligible fund to which any person who bears a relationship to the individual described in section 267(b) or 707(b) has a right.

(iv) Regulation and information reporting--(A) In general. The eligible fund must be subject to government regulation and annually provide to the relevant tax authorities (or other relevant governmental units) in the foreign jurisdiction in which the eligible fund is established or operates information about the amount of qualified benefits (if any) provided to each qualified recipient by the eligible fund, or such information must otherwise be available to the relevant tax authorities (or other relevant governmental units). An eligible fund is not treated as failing to satisfy the requirement of this paragraph (c)(2)(iv)(A) as a result of the eligible fund not being required to provide information to the relevant tax authorities (or other relevant governmental units) in a year in which no qualified benefits are provided to qualified recipients.

(B) Treatment of certain eligible funds established by foreign jurisdictions. An eligible fund that is described in paragraph (c)(2)(ii)(A)(1)(i) of this section is deemed to satisfy the requirements of paragraph (c)(2)(iv)(A) of this section.

(v) Tax treatment--(A) In general. The tax laws of the foreign jurisdiction in which the eligible fund is established or operates must provide that, due to the status of the eligible fund as a retirement or pension fund, either--

(1) Contributions to the eligible fund that would otherwise be subject to tax under such laws are deductible or excluded from the gross income of the eligible fund or taxed at a reduced rate; or

(2) Taxation of any investment income of the eligible fund is deferred or excluded from the gross income of the eligible fund or such income is taxed at a reduced rate.

(B) Income subject to preferential tax treatment. An eligible fund is treated as satisfying the requirement of paragraph (c)(2)(v)(A) of this section in a taxable year if, under the tax laws of the foreign jurisdiction in which the eligible fund is established or operates--

(1) At least 85 percent of the contributions to the eligible fund are subject to the tax treatment described in paragraph (c)(2)(v)(A)(1) of this section, or

(2) At least 85 percent of the investment income of the eligible fund is subject to the tax treatment described in paragraph (c)(2)(v)(A)(2) of this section.

(C) Income not subject to tax. An eligible fund is treated as satisfying the requirement of paragraph (c)(2)(v)(A) of this section if the eligible fund is exempt from the income tax of the foreign jurisdiction in which it is established or operates or the foreign jurisdiction in which it is established or operates has no income tax.

(D) Other preferential tax regimes. An eligible fund that does not receive the tax treatment described in either paragraph (c)(2)(v)(A)(1) or (2) of this section is nonetheless treated as satisfying the requirement of paragraph (c)(2)(v)(A) of this section if the eligible fund establishes that each of the conditions described in paragraphs (c)(2)(v)(D)(1) and (2) of this section is satisfied:

(1) Under the tax laws of the foreign jurisdiction in which the eligible fund is established or operates, the eligible fund is subject to a preferential tax regime due to its status as a retirement or pension fund; and

(2) The preferential tax regime described in paragraph (c)(2)(v)(D)(1) of this section has a substantially similar effect as the tax treatment described in paragraphs (c)(2)(v)(A)(1) or (2) of this section.

(E) Tax law of subnational jurisdictions. Solely for purposes of this paragraph (c)(2)(v), a reference to the tax law of a foreign jurisdiction includes the tax law of a political subdivision or other local authority of a foreign jurisdiction, provided that income taxes imposed under the subnational tax law are treated as covered taxes under an income tax treaty between that foreign jurisdiction and the United States.

(3) Operating rules--(i) Rules on the application of the requirements in paragraph (c)(2) of this section--(A) Organizations or arrangements. An organization or arrangement is treated as a single entity for purposes of determining whether the requirements of paragraph (c)(2) of this section are satisfied, except that each person or governmental unit that is part of or party to an organization or arrangement must satisfy the requirement of paragraph (c)(2)(i) of this section.

(B) Relevant income, assets, and functions. The determination of whether an eligible fund satisfies the requirements of paragraph (c)(2) of this section is made solely with respect to the assets and income of the eligible fund held in one or more qualified segregated accounts, the qualified benefits funded by the qualified segregated accounts, the information reporting and regulation related to the qualified segregated accounts, and the qualified recipients whose benefits are funded by the qualified segregated accounts. For this purpose, all assets held by an eligible fund in qualified segregated accounts (within the meaning of paragraph (e)(13)(ii) of this section) are treated as a single qualified segregated account.

(ii) Aggregate approach to partnerships. For purposes of this section, assets held by a partnership shall be treated as held proportionately by its partners, and activities conducted by a partnership shall be treated as conducted by its partners.

(iii) Recordkeeping. An eligible fund that claims the exemption under section 897(l) must have records sufficient to establish that it satisfies the requirements of paragraph (c)(2) of this section. See section 6001 and §1.6001-1, requiring records to be maintained.

(d) Qualified holder requirements--(1) In general. With respect to a disposition described in section 897(a) or a distribution described in section 897(h), a qualified foreign pension fund (including a part of a qualified foreign pension fund) or a qualified controlled entity is a qualified holder only if it satisfies the requirement of paragraph (d)(2) or (3) of this section.

(2) Qualified holders that did not hold U.S. real property interests. The requirement of this paragraph (d)(2) is satisfied if the qualified foreign pension fund or qualified controlled entity owned no United States real property interests as of the earliest date during an uninterrupted period, ending on the date of the disposition or distribution, in which the qualified foreign pension fund or qualified controlled entity satisfied the requirements of paragraph (c)(2) of this section or paragraph (e)(9) of this section, as applicable.

(3) Qualified holders that satisfy the testing period--(i) In general. The requirement of this paragraph (d)(3) is satisfied if the qualified foreign pension fund or qualified controlled entity continuously satisfies the requirements of paragraph (c)(2) of this section or paragraph (e)(9) of this section, as applicable, for the duration of the testing period.

(ii) Testing Period. The term testing period means whichever of the following periods is the shortest:

(A) The period beginning on December 18, 2015, and ending on the date of the disposition or the distribution;

(B) The ten-year period ending on the date of the disposition or the distribution;
and,

(C) The period beginning on the date the entity (or its predecessor) was created or organized and ending on the date of the disposition or the distribution.

(4) Transition Rules--(i) Qualified foreign pension fund or qualified controlled entity requirements. With respect to any period from December 18, 2015, to the date when the requirements of paragraph (c)(2) or (e)(9) of this section first apply to a qualified foreign pension fund or qualified controlled entity under paragraph (g) of this section, as applicable (but in any event no later than **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, in the case of paragraph (c)(2) of this section, and no later than June 6, 2019, in the case of paragraph (e)(9) of this section), the qualified foreign pension fund or qualified controlled entity is deemed to satisfy the requirements of paragraphs (c)(2) and (e)(9) of this section, as applicable, for purposes of paragraphs (d)(2) and (3) of this section if the qualified foreign pension fund or qualified controlled entity satisfies the requirements of section 897(l)(2) based on a reasonable interpretation of those requirements (including determining any applicable valuations using a consistent method).

(ii) Ownership of qualified controlled entity by service providers. Solely for purposes of paragraphs (d)(2) and (3) of this section, the determination of whether a corporation or trust is a qualified controlled entity will not include stock or interests held directly or indirectly by any person that provides services to such corporation or trust, provided that such stock or interests are, in the aggregate, no more than five percent (by vote or value) of the stock or interests of such corporation or trust. This paragraph (d)(4)(ii) applies to interests held from December 18, 2015 until **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

(e) Definitions. The following definitions apply for purposes of this section.

(1) Ancillary benefits--(i) In general. The term ancillary benefits means--

(A) Benefits payable upon the diagnosis of a terminal illness, incidental death benefits (for example, funeral expenses), short-term disability benefits, life insurance benefits, and medical benefits;

(B) Unemployment, shutdown, or layoff benefits that do not continue past retirement age and do not affect the payment of accrued retirement and pension benefits; and

(C) Other health-related or unemployment benefits that are similar to the benefits described in paragraphs (e)(1)(i) and (ii) of this section.

(ii) Overlap with retirement and pension benefits. Ancillary benefits do not include any benefits that could also be defined as retirement and pension benefits within the meaning of paragraph (e)(14) of this section.

(2) Eligible fund. The term eligible fund means a trust, corporation, or other organization or arrangement that maintains one or more qualified segregated accounts.

(3) Employer group. The term employer group means all individuals, trusts, partnerships, and corporations with a relationship to each other specified in section 267(b) or section 707(b).

(4) Foreign jurisdiction. The term foreign jurisdiction means a jurisdiction other than the United States, including a country, a state, province, or political subdivision of a foreign country, and a territory of the United States.

(5) Governmental unit. The term governmental unit means any foreign government or part thereof, including any person, body, group of persons, organization, agency, bureau, fund, or instrumentality, however designated, of a foreign government.

(6) Non-ancillary benefits. The term non-ancillary benefits means benefits that are neither ancillary benefits (within the meaning of paragraph (e)(1) of this section) nor retirement and pension benefits (within the meaning of paragraph (e)(14) of this

section), and are provided by the eligible fund as permitted or required under the laws of the foreign jurisdiction in which the eligible fund is established or operates.

(7) Organization or arrangement. The term organization or arrangement means one or more trusts, corporations, governmental units, or employers.

(8) Qualified benefits. The term qualified benefits means retirement and pension benefits, ancillary benefits and non-ancillary benefits. However, the portions of qualified benefits consisting of ancillary benefits and non-ancillary benefits provided by a qualified foreign pension fund are limited as provided in paragraph (c)(2)(ii)(B) of this section.

(9) Qualified controlled entity. The term qualified controlled entity means a trust or corporation created or organized under the laws of a foreign jurisdiction all of the interests of which are held by one or more qualified foreign pension funds directly or indirectly through one or more qualified controlled entities.

(10) Qualified foreign pension fund. The term qualified foreign pension fund means an eligible fund that satisfies the requirements of paragraph (c) of this section.

(11) Qualified holder. The term qualified holder means a qualified foreign pension fund or qualified controlled entity that satisfies the requirements of paragraph (d) of this section.

(12) Qualified recipient--(i) In general. The term qualified recipient means--

(A) With respect to an eligible fund described in paragraph (c)(2)(ii)(A)(1)(i) of this section, any person eligible to be treated as a participant or beneficiary of such eligible fund and any person designated by such participant or beneficiary to receive qualified benefits, and

(B) With respect to an eligible fund described in paragraph (c)(2)(ii)(A)(1)(ii) of this section, a current or former employee, a spouse of a current or former employee,

and any person designated by such participants or beneficiaries to receive qualified benefits.

(C) To the extent not already described in paragraph (e)(12)(i)(B) of this section, with respect to an eligible fund described in paragraph (c)(2)(ii)(A)(1)(ii) of this section, any person eligible to be treated as a participant or beneficiary of such fund and any person designated by such participant or beneficiary to receive qualified benefits, so long as such recipients do not exceed five percent of the eligible fund's total qualified recipients or have a right to more than five percent of the assets or income of the eligible fund. An eligible fund must make a determination for purposes of this paragraph (e)(12)(i)(C) on at least an annual basis and may utilize any reasonable method in doing so. An eligible fund must use its most recent determination under this paragraph with respect to dispositions of United States real property interests or distributions described in section 897(h) occurring in the twelve months succeeding such determination, or until a new determination is made, whichever occurs first.

(ii) Special rule regarding automatic designation. For purposes of paragraph (e)(12)(i) of this section, a person is treated as designating another person to receive qualified benefits if the other person is, by reason of such person's relationship or other status with respect to the first person, entitled to receive benefits pursuant to the terms applicable to the eligible fund or pursuant to the laws of the foreign jurisdiction in which the eligible fund is created or organized, whether or not the first person expressly designated such person as a beneficiary.

(13) Qualified segregated account--(i) In general. The term qualified segregated account means an identifiable pool of assets maintained by an eligible fund or a qualified controlled entity for the sole purpose of funding and providing qualified benefits to qualified recipients.

(ii) Assets held by eligible funds. For purposes of paragraph (e)(13)(i) of this section, an identifiable pool of assets of an eligible fund is treated as maintained for the sole purpose of funding qualified benefits to qualified recipients, and hence as a qualified segregated account, only if the terms applicable to the eligible fund or the laws of the foreign jurisdiction in which the eligible fund is established or operates require that all the assets in the pool, and all the income earned with respect to such assets, be used exclusively to fund the provision of qualified benefits to qualified recipients or to satisfy necessary reasonable expenses of the eligible fund, and that such assets or income may not inure to the benefit of a person other than a qualified recipient. For purposes of this paragraph (e)(13)(ii), the fact that assets or income may inure to the benefit of a governmental unit by operation of escheat or similar laws, or may revert (such as upon plan termination or dissolution (after all obligations to qualified recipients and creditors have been satisfied) or the qualified recipients' benefits failing to vest) to the governmental unit or employer in accordance with applicable foreign law is ignored, so long as contributions to the plan are not more than reasonably necessary to fund the qualified benefits to be provided to qualified recipients.

(iii) Assets held by qualified controlled entities. For purposes of paragraph (e)(13)(i) of this section, the assets of a qualified controlled entity are treated as an identifiable pool of assets maintained for the sole purpose of funding qualified benefits to qualified recipients only if both of the following requirements are satisfied:

(A) All of the net earnings of the qualified controlled entity are credited to its own account or to the qualified segregated account of a qualified foreign pension fund or another qualified controlled entity, with no portion of the net earnings of the qualified controlled entity inuring to the benefit of a person other than a qualified recipient; and

(B) Upon dissolution, all of the assets of the qualified controlled entity, after satisfaction of liabilities to persons having interests in the entity solely as creditors, vest

in a qualified segregated account of a qualified foreign pension fund or another qualified controlled entity.

(14) Retirement and pension benefits. The term retirement and pension benefits means distributions to qualified recipients that are made after the qualified recipient reaches retirement age as determined under or in accordance with the laws in the foreign jurisdiction in which the eligible fund is established or operates (including a benefit paid to a qualified recipient who retires on or after a stated early retirement age), or after a specified event that results in a qualified recipient being permanently unable to work, and includes any such distribution made to a surviving beneficiary of the qualifying recipient. Retirement and pension benefits may be based on one or more of the following factors: contributions, investment performance, years of service with an employer, or compensation received by the qualified recipient.

(f) Examples. This paragraph (f) provides examples that illustrate the rules of this section. The examples do not illustrate the application of the applicable withholding rules, including sections 1445 and 1446 and the regulations thereunder. It is assumed that no person is entitled to more than five percent of any eligible fund's assets or income, taking into account the constructive ownership rules in paragraph (c)(2)(iii)(B) of this section, and that the eligible fund owns no United States real property interests other than as described.

(1) Example 1: No legal entity--(i) Facts. On January 1, 2023, Country A establishes Retirement Plan for the sole purpose of providing retirement and pension benefits to citizens of Country A aged 65 or older. Retirement Plan is composed of Asset Pool and Agency. Asset Pool is a group of accounts maintained on the balance sheet of the government of Country A. Pursuant to the laws of Country A, income and gain earned by Asset Pool is used solely to support the provision of retirement and pension benefits by Retirement Plan. Agency is a Country A agency that administers the provision of benefits by Retirement Plan and manages Asset Pool's investments. Under the laws of Country A, investment income earned by Retirement Plan is not subject to Country A's income tax. At the end of each calendar year, Retirement Plan performs a present valuation of the retirement and pension benefits it reasonably expects to provide in the future, and all of the benefits that Retirement Plan reasonably expects to provide are retirement and pension benefits. On January 1, 2024, Agency purchases Property, which is an interest in real property located in the United States

owned by Asset Pool. On June 1, 2026, Agency sells Property, realizing \$100x of gain with respect to Property that would be subject to tax under section 897(a) unless paragraph (b) of this section applies with respect to the gain.

(ii) Analysis. (A) Retirement Plan, which is composed of Asset Pool and Agency, includes one or more governmental units described in paragraph (e)(5) of this section. Accordingly, Retirement Plan is an organization or arrangement described in paragraph (e)(7) of this section. Furthermore, Retirement Plan maintains a qualified segregated account in the form of Asset Pool, an identifiable pool of assets maintained for the sole purpose of funding retirement and pension benefits to beneficiaries of the Retirement Fund (qualified recipients as defined in paragraph (e)(12)(i)(A) of this section). Therefore, Retirement Plan is an eligible fund within the meaning of paragraph (e)(2) of this section.

(B) Paragraph (c)(3)(i) of this section applies for purposes of determining whether Retirement Plan is an eligible fund that satisfies the requirements of paragraph (c)(2) of this section and would therefore be treated as a qualified foreign pension fund. Accordingly, the activities of Asset Pool and Agency are integrated and treated as undertaken by a single entity to determine whether the requirements of paragraph (c)(2) of this section are met. However, Asset Pool and Agency must independently satisfy the requirement of paragraph (c)(2)(i) of this section.

(C) Retirement Plan is composed of Asset Pool and Agency, each of which is a governmental unit and treated as created or organized under the laws of Country A for purposes of paragraph (c)(2)(i) of this section. Accordingly, Retirement Plan satisfies the requirement of paragraph (c)(2)(i) of this section.

(D) Retirement Plan is established by Country A as an eligible fund described in paragraph (c)(2)(ii)(A)(1)(i) of this section to provide retirement and pension benefits, which are qualified benefits described in paragraph (e)(8) of this section, to citizens of Country A, who are qualified recipients described in paragraph (e)(12)(i)(A) of this section because they are eligible to be participants or beneficiaries of Retirement Plan. Accordingly, all of the benefits that Retirement Plan provides are qualified benefits provided to qualified recipients. In addition, Retirement Plan satisfies the requirements of the present valuation test as described in paragraphs (c)(2)(ii)(B) and (C) of this section. Accordingly, Retirement Plan satisfies the requirement of paragraph (c)(2)(ii) of this section.

(E) Retirement Plan provides retirement and pension benefits to citizens of Country A aged 65 or older, with no citizen entitled to more than five percent of Retirement Fund's assets or to more than five percent of the income of the eligible fund. Accordingly, Retirement Plan satisfies the requirement of paragraph (c)(2)(iii) of this section.

(F) Retirement Plan is composed solely of governmental units within the meaning of paragraph (e)(5) of this section. Accordingly, under paragraph (c)(2)(iv)(B) of this section, Retirement Plan is treated as satisfying the requirements of paragraph (c)(2)(iv)(A) of this section.

(G) Investment income earned by Retirement Plan is not subject to income tax in Country A. Accordingly, Retirement Plan satisfies the requirement of paragraph (c)(2)(v) of this section.

(H) Because Retirement Plan satisfies the requirements of paragraph (c)(2) of this section, Retirement Plan is a qualified foreign pension fund. Because Retirement Plan held no United States real property interests as of January 1, 2023, the earliest date during an uninterrupted period ending on June 1, 2026, the date of the disposition, in which it satisfied the requirements of paragraph (c)(2) of this section, Retirement Plan is a qualified holder under paragraph (d)(2) of this section. Retirement Plan's gain with respect to Property is attributable solely to Asset Pool, a qualified segregated account maintained by Retirement Plan. Accordingly, under paragraph (b) of this section, the \$100x gain realized by Retirement Plan attributable to the disposition of Property is not subject to section 897(a).

(2) Example 2: Fund established by an employer--(i) Facts. Employer, a corporation organized in Country B, establishes Fund to provide retirement and pension benefits to current and former employees of Employer and S1, a Country B corporation that is wholly owned by Employer. On January 1, 2023, Fund is established as a trust under the laws of Country B, and Employer retains discretion to invest assets and to administer benefits on Fund's behalf. Fund receives contributions from Employer and S1 and contributions from employees of Employer and S1 who are beneficiaries of Fund. All contributions to Fund and all of Fund's earnings are separately accounted for on Fund's books and records and are required by Fund's organizational documents to exclusively fund the provision of benefits to Fund's beneficiaries, except as necessary to satisfy reasonable expenses of Fund. Fund currently has over 100 beneficiaries, a number that is reasonably expected to grow as Employer expands. Fund will pay benefits to employees upon retirement based on years of service and employee contributions, but, if a beneficiary dies before retirement, Fund will pay an incidental death benefit in addition to payment of any accrued retirement and pension benefits to the beneficiary's designee (or deemed designee under local laws if the beneficiary fails to identify a designee). Fund annually performs a present valuation of the benefits it reasonably expects to provide to Fund's beneficiaries, and the valuation concludes that more than 85 percent of the present value of the total benefits it reasonably expects to pay to its beneficiaries in the future are retirement and pension benefits. In addition, it is reasonably expected that the incidental death benefits paid by Fund will account for less than fifteen percent of the present value of the total benefits that Fund expects to provide in the future, and Fund does not reasonably expect to pay any other types of benefits to its beneficiaries in the future. Fund annually provides to the tax authorities of Country B the amount of benefits distributed to each participant (or designee). Country B's tax authorities prescribe rules and regulations governing Fund's operations. Under the laws of Country B, Fund is not taxed on its investment income. On January 1, 2024, Fund purchases Property, which is an interest in real property located in the United States. On June 1, 2026, Fund sells Property, realizing \$100x of gain with respect to Property that would be subject to tax under section 897(a) unless paragraph (b) of this section applies with respect to the gain.

(ii) Analysis. (A) Fund is a trust that maintains an identifiable pool of assets for the sole purpose of funding retirement and pension benefits and ancillary benefits to current and former employees of the employer group (within the meaning of paragraph (e)(3) of this section) that includes Employer and S1 (current and former employees of Employer and S1 constitute qualified recipients, as defined in paragraph (e)(12)(i)(B) of this section). All assets held by Fund and all income earned by Fund are used to provide such benefits. Therefore, Fund is a trust that maintains a qualified segregated

account within the meaning of paragraph (e)(13) of this section. Accordingly, Fund is an eligible fund within the meaning of paragraph (e)(2) of this section.

(B) Because Fund is created or organized under the laws of Country B, Fund satisfies the requirement of paragraph (c)(2)(i) of this section.

(C) The only benefits that Fund provides are retirement and pension benefits described in paragraph (e)(14) of this section and ancillary benefits (that is, the incidental death benefits) described in paragraph (e)(1) of this section, both of which constitute qualified benefits described in paragraph (e)(8) of this section, to qualified recipients, described in paragraph (e)(12)(i)(B) of this section. Furthermore, Fund satisfies the requirements of the present valuation test as described in paragraphs (c)(2)(ii)(B) and (C) of this section. Accordingly, Fund is established by Employer to provide retirement and pension benefits to qualified recipients in consideration for services rendered by such qualified recipients to Employer and S1, and Fund satisfies the requirement of paragraph (c)(2)(ii) of this section.

(D) No single qualified recipient has a right to more than five percent of the assets or income of the eligible fund. Accordingly, Fund satisfies the requirement of paragraph (c)(2)(iii) of this section.

(E) Fund is regulated and annually provides to the relevant tax authorities in the foreign jurisdiction in which it is established or operates the amount of qualified benefits provided to each qualified recipient by the eligible fund. Accordingly, Fund satisfies the requirements of paragraph (c)(2)(iv) of this section.

(F) Fund is not subject to income tax on its investment income. Accordingly, Fund satisfies the requirement of paragraph (c)(2)(v) of this section.

(G) Because Fund meets the requirements of paragraph (c)(2) of this section, Fund is treated as a qualified foreign pension fund. Furthermore, because Fund held no United States real property interests as of January 1, 2023, the earliest date during an uninterrupted period ending on June 1, 2026, the date of the disposition, in which it satisfied the requirements of paragraph (c)(2) of this section, Fund is a qualified holder under paragraph (d)(2) of this section. All of Fund's assets are held in a qualified segregated account within the meaning of paragraph (e)(13) of this section. Accordingly, under paragraph (b) of this section, the \$100x gain attributable to the disposition of Property is not subject to section 897(a).

(3) Example 3: Fund established by an employer at the direction of a foreign jurisdiction--(i) Facts. The facts are the same as in paragraph (f)(2) of this section (Example 2), except that Fund was established by Employer at the direction of Country B and, in addition to being established to provide retirement and pension benefits to current and former employees of Employer and S1, Fund was also established to provide retirement and pension benefits to other employees. All employees that are beneficiaries provide contributions to Fund. Fund makes a determination on at least an annual basis using a reasonable method to measure the number of participants in the Fund who are not current and former employees of Employer and S1. Each time such a determination is made, Fund finds that such employees constitute less than five percent of Fund's total qualified recipients and do not have a right to more than five percent of the assets or income of Fund.

(ii) Analysis. Fund satisfies the requirements of paragraph (c)(2)(ii)(A)(1)(i) of this section because it was established by, or at the direction of, Country B to provide retirement and pension benefits to participants or beneficiaries that are current or former employees or persons designated by such employees as a result of services rendered by such employees to their employers. Fund also satisfies the requirements of paragraph (c)(2)(ii)(A)(1)(ii) of this section because it was established by Employer to provide retirement and pension benefits to participants or beneficiaries that are current or former employees or persons designated by such employees in consideration for services rendered by such employees to Employer and S1. Because it satisfies the requirements of both such provisions, under paragraph (c)(2)(ii)(A)(2) of this section, Fund will be treated solely as an eligible fund under paragraph (c)(2)(ii)(A)(1)(ii) of this section. As a result, Fund must meet the reporting requirements described in paragraph (c)(2)(iv)(A) of this section and must apply the definition of qualified recipient described in paragraphs (e)(12)(i)(B) and (C) of this section. Because Fund makes a determination on at least an annual basis using a reasonable method to measure the number of participants in the Fund who are not current and former employees of Employer and S1, finding that such employees constitute less than five percent of Fund's total qualified recipients and do not have a right to more than five percent of the assets or income of Fund, the requirement of paragraph (c)(2)(ii)(B)(1) of this section, requiring that all of the benefits that an eligible fund provides are provided to qualified recipients, is considered satisfied. Because Fund meets the requirements of paragraph (c)(2) of this section, Fund is treated as a qualified foreign pension fund under paragraph (b) of this section. Accordingly, the \$100x gain attributable to the disposition of Property is not subject to section 897(a).

(4) Example 4: Employer controlled organization or arrangement--(i) Facts. The facts are the same as in paragraph (f)(2) of this section (Example 2), except that S2, a Country B corporation that is wholly owned by Employer, performs all tax compliance functions for Employer, S1, and S2, including information reporting with respect to Fund participants.

(ii) Analysis. For purposes of the requirements of paragraph (c)(2) of this section, Fund and S2 are an organization or arrangement that is treated as a single entity under paragraph (c)(3)(i)(A) of this section and an eligible fund under paragraph (e)(2) of this section with respect to the qualified segregated account held by Fund. Because the eligible fund composed of Fund and S2 satisfies the requirements of paragraph (c)(2) of this section (including the rule under paragraph (c)(3)(i)(A) of this section that each entity satisfy the foreign organization requirement of paragraph (c)(2)(i) of this section) with respect to the qualified benefits provided to the qualified recipients out of the eligible fund's qualified segregated account (determined in accordance with paragraph (c)(3)(i)(B) of this section), the eligible fund that is composed of Fund and S2 constitutes a qualified foreign pension fund. Furthermore, the requirements for qualified holder status are satisfied, as described in paragraph (f)(2) of this section. Thus, under paragraph (b) of this section, the \$100x gain attributable to the disposition of Property is not subject to section 897(a).

(5) Example 5: Third-party assumption of pension liabilities--(i) Facts. The facts are the same as in paragraph (f)(2) of this section (Example 2), except that Fund does not purchase Property on January 1, 2024. In addition, Fund anticipates \$100x of qualified benefits will be paid each year beginning on January 1, 2028. Fund enters into an agreement with Guarantor, a privately held Country B corporation, which provides that Fund will, on January 30, 2023, cede a portion of its assets to Guarantor in

exchange for annual payments of \$100x beginning on January 1, 2028 and continuing until one or more previously identified participants (and their designees) ceases to be eligible to receive benefits. Guarantor has discretion to invest the ceded assets as it chooses, subject to certain agreed upon investment restrictions. Pursuant to its agreement with Fund, Guarantor must maintain Segregated Pool, a pool of assets securing its obligations under its agreement with Fund. The value of Segregated Pool must exceed a specified amount (determined based on an agreed upon formula) until Guarantor's payment obligations are completed, and any remaining assets in Segregated Pool (that is, assets exceeding the required payments to Fund) are retained by Guarantor. Guarantor bears all investment risk with respect to Segregated Pool. Accordingly, Guarantor is required to make annual payments of \$100x to Fund regardless of the performance of Segregated Pool. On January 1, 2024, Guarantor purchases stock in Company A, a United States real property holding company that is a United States real property interest, and holds the Company A stock in Segregated Pool. On June 1, 2027, Guarantor sells the stock in Company A, realizing a gain of \$100x.

(ii) Analysis. The Segregated Pool is not a qualified segregated account, because it is not maintained for the sole purpose of funding qualified benefits to qualified recipients, and because income attributable to assets in the Segregated Pool (including the Company A stock) may inure to Guarantor, which is not a qualified recipient. Accordingly, Fund and Guarantor do not qualify as an organization or arrangement that is an eligible fund with respect to the Company A stock. Therefore, Guarantor is not exempt under paragraph (b) of this section with respect to the \$100x of gain realized in connection with the sale of its shares in Company A.

(6) Example 6: Asset manager--(i) Facts. The facts are the same as in paragraph (f)(5) of this section (Example 5) except that instead of ceding legal ownership of a portion of its assets to Guarantor, Fund transfers the assets into Trust with respect to which Fund is the sole beneficiary on January 30, 2023, and Trust purchases stock in Company A on January 1, 2024. Guarantor has exclusive management authority over the Trust assets and is entitled to a reasonable fixed management fee which it withdraws annually from Trust's assets. On June 1, 2027, Trust sells the stock in Company A, realizing a gain of \$100x.

(ii) Analysis. For purposes of testing the requirements of paragraph (c)(2) of this section, Fund and Trust are an organization or arrangement that is treated as a single entity under paragraph (c)(3)(i)(A) of this section and an eligible fund under paragraph (e)(2) of this section. Assets held by Trust are held in a qualified segregated account, and those assets are the assets that are relevant for purposes of determining whether the eligible fund composed of Fund and Trust meets the requirements of paragraph (c)(2) of this section. The eligible fund that is composed of Fund and Trust is treated as established by Employer notwithstanding that Guarantor provides management services. See paragraph (c)(2)(ii)(A)(3) of this section. Paragraph (e)(13)(ii) of this section provides that the assets held by an eligible fund in a qualified segregated account may be used to satisfy reasonable expenses of the eligible fund, such that the reasonable fixed management fee paid to Guarantor does not cause the assets held in Trust to fail to be treated as held in a qualified segregated account. All of the other requirements for qualified foreign pension fund status are satisfied by the eligible fund that is composed of Fund and Trust, as described in paragraph (f)(2) of this section. The eligible fund that is composed of Fund and Trust is a qualified holder under paragraph (d)(2) of this section because it held no United States real property interests

on January 1, 2023, the earliest date during an uninterrupted period ending on June 1, 2027, the date of the disposition of Company A stock, in which it satisfied the requirements of paragraph (c)(2) of this section. The eligible fund that is composed of Fund and Trust is therefore exempt under paragraph (b) of this section with respect to the \$100x of gain realized in connection with the sale by Trust of the shares in Company A.

(7) Example 7: Partnership--(i) Facts. The facts are the same as in paragraph (f)(5) of this section (Example 5) except that instead of ceding legal ownership of the assets to Guarantor, Fund contributes the assets to a partnership (PRS) formed with Guarantor and PRS purchases stock in Company A on January 30, 2023. Guarantor receives a profits interest in the partnership that is reasonable in light of Guarantor's management activity. Guarantor has no direct or indirect ownership in PRS assets, and the partnership agreement provides that upon dissolution, PRS assets would be distributed to Fund. Guarantor serves as the general partner of PRS and has discretionary authority to buy and sell PRS assets without approval from Fund. On June 1, 2027, PRS sells the stock in Company A, realizing a gain of \$100x.

(ii) Analysis. All of Fund's assets, including the assets held by PRS that are treated as held proportionately by Fund under paragraph (c)(3)(ii) of this section, are held in a qualified segregated account within the meaning of paragraph (e)(13) of this section. See paragraph (f)(2)(ii)(A) of this section (Example 2). The eligible fund that is composed of Fund is treated as established by Employer notwithstanding that Guarantor provides management services to PRS. See paragraphs (c)(2)(ii)(A)(3) and (c)(3)(ii) of this section. All of the other requirements for qualified foreign pension fund status are satisfied by Fund as described in paragraphs (f)(2)(ii)(B) through (F) of this section, and Fund is a qualified holder as described in paragraph (f)(2)(ii)(G) of this section. Accordingly, Fund is exempt under paragraph (b) of this section with respect to its allocable share of the \$100x of gain realized in connection with the sale by PRS of the shares in Company A. Guarantor is not exempt under paragraph (b) of this section with respect to its allocable share of the \$100x of gain realized in connection with the sale by PRS of the shares in Company A because Guarantor is neither part of the organization or arrangement that forms Fund nor a qualified holder under paragraph (d) of this section that maintains qualified segregated accounts.

(8) Example 8: Not a qualified holder--(i) Facts. Fund is a qualified foreign pension fund organized in Country C that meets the requirements of paragraph (c)(2) of this section. Fund owns all the outstanding stock of OpCo, a manufacturing corporation organized in Country C, in a qualified segregated account maintained by Fund. OpCo was originally formed by a person other than Fund on January 1, 2023. Fund purchased all of the stock of OpCo on November 1, 2023 for the purpose of conducting the manufacturing business and utilizing the business profits to fund pension liabilities. During the period from January 1, 2023, through October 31, 2023, OpCo was not a qualified foreign pension fund, a part of a qualified foreign pension fund, or a qualified controlled entity. On January 30, 2023, OpCo purchased Property A, a United States real property interest, from a third party. For all periods after Fund acquired OpCo, OpCo must either retain or distribute to Fund all of its net earnings, and upon dissolution, must distribute all of its assets to its stockholder (that is, Fund) after satisfaction of liabilities to its creditors. On June 1, 2024, OpCo realizes \$100x of gain on the disposition of Property A.

(ii) Analysis. (A) A qualified controlled entity described in paragraph (e)(9) of this section includes any corporation organized under the laws of a foreign jurisdiction all the interests of which are owned by one or more qualified foreign pension funds directly or indirectly through one or more qualified controlled entities. Fund is a qualified foreign pension fund that wholly owns OpCo. Accordingly, OpCo is a qualified controlled entity for the period when it is owned by Fund beginning on November 1, 2023.

(B) Under paragraph (d)(1) of this section, a qualified controlled entity is a qualified holder only if either, under paragraph (d)(2) of this section, the qualified controlled entity owned no United States real property interests as of the earliest date during an uninterrupted period ending on the date of the disposition or distribution in which the qualified controlled entity satisfied the requirements of paragraph (e)(9) of this section, or, under paragraph (d)(3) of this section, the qualified controlled entity satisfies the requirements of paragraph (e)(9) of this section throughout the entire testing period. Because OpCo owned a United States real property interest as of November 1, 2023, the earliest date during an uninterrupted period ending on the date of the disposition during which it satisfied the requirements of paragraph (e)(9) of this section, OpCo cannot satisfy the requirements of paragraph (d)(2) of this section and must instead satisfy the requirements of paragraph (d)(3) of this section to be a qualified holder. Under paragraph (d)(3) of this section, a qualified holder does not include any entity that was not a qualified foreign pension fund, a part of a qualified foreign pension fund, or a qualified controlled entity at any time during the testing period. The testing period with respect to OpCo is the period from January 1, 2023 (the date of OpCo's formation), to June 1, 2024 (the date of the disposition). Because OpCo was not a qualified foreign pension fund, a part of a qualified foreign pension fund, or a qualified controlled entity from January 1, 2023, to October 31, 2023, OpCo was not a qualified foreign pension fund, a part of a qualified foreign pension fund, or a qualified controlled entity at all times during the testing period. Accordingly, OpCo is not a qualified holder with respect to the disposition of Property A, and the \$100x of gain recognized by OpCo is not exempt from tax under section 897(l), regardless of the amount of unrealized gain in Property A as of November 1, 2023.

(9) Example 9: 48-month alternative test--(i) Facts. Fund is a qualified foreign pension fund organized in Country C that, except as otherwise noted, meets the requirements of paragraph (c)(2) of this section. Fund owns all the outstanding stock of OpCo, a manufacturing corporation organized in Country C and formed by Fund on January 1, 2023, in a qualified segregated account maintained by Fund. On January 30, 2023, OpCo purchased Property A, a United States real property interest, from a third party. OpCo either retains or distributes to Fund all of its net earnings, and upon dissolution, must distribute all of its assets to its stockholder (that is, Fund) after satisfaction of liabilities to its creditors. On June 1, 2027, OpCo realizes \$100x of gain on the disposition of Property A. Fund reasonably expected to provide \$90x of retirement and pension benefits and \$100x of qualified benefits for the valuations that it performed pursuant to paragraph (c)(2)(ii)(C)(1) of this section on December 31, 2023, December 31, 2024, and December 31, 2025. Fund reasonably expected to provide \$160x of retirement and pension benefits and \$200x of qualified benefits for the valuation that it performed pursuant to paragraph (c)(2)(ii)(C)(1) of this section on December 31, 2026.

(ii) Analysis. In each of the years ending on December 31, 2023, December 31, 2024, and December 31, 2025, the valuation performed pursuant to paragraph (c)(2)(ii)(C)(1) of this section demonstrates that the requirements of paragraph

(c)(2)(ii)(B)(2) of this section have been met because \$90x of retirement and pension benefits constitutes 90 percent of the total \$100x of qualified benefits. For the year ending on December 31, 2026, the valuation performed pursuant to paragraph (c)(2)(ii)(C)(1) of this section does not demonstrate that the requirements of paragraph (c)(2)(ii)(B)(2) of this section have been met because \$160x of retirement and pension benefits constitutes only 80 percent of the total \$200x of qualified benefits. Thus, Fund does not meet the requirements of paragraph (c)(2)(ii)(C)(1) of this section for the year ending on December 31, 2026. However, under the 48-month alternative calculation in paragraph (c)(2)(ii)(C)(2) of this section, Fund satisfies the requirement that it reasonably expects to provide 85 percent retirement and pension benefits to qualified recipients as of December 31, 2026. This is because when averaging the values (not percentages) of the qualified benefits and retirement and pension benefits that Fund reasonably expected to provide from the valuations performed over the preceding 48 months (including the most recent valuation), Fund divides the total retirement and pension benefits of \$430x (\$90x + \$90x + \$90x + \$160x) by the total qualified benefits that it reasonably expected to provide of \$500x (\$100x + \$100x + \$100x + \$200x) for an average of 86 percent. Under paragraph (c)(2)(ii)(C)(3) of this section, Fund may rely on either the most recent present valuation described in paragraph (c)(2)(ii)(C)(1) of this section or the alternative calculation in paragraph (c)(2)(ii)(C)(2) of this section, both of which are determined as of December 31, 2026. Because Fund satisfies the requirements of paragraph (c)(2)(ii)(B)(2) of this section under the test in paragraph (c)(2)(ii)(C)(2) of this section, even though it does not do so under the test in paragraph (c)(2)(ii)(C)(1) of this section, Fund is a qualified foreign pension fund with respect to the disposition on June 1, 2027. Because OpCo is held by a qualified foreign pension fund as of the date of the disposition, OpCo is a qualified controlled entity within the meaning of paragraph (e)(9) of this section. Accordingly, the \$100x of gain realized by OpCo is exempt from tax under section 897(l).

(10) Example 10: 48-month alternative test with multiple valuations in the same year--(i) Facts. The facts are the same as in paragraph (f)(9) of this section (Example 9), except that in the year ending December 31, 2023, Fund carried out two valuations pursuant to paragraph (c)(2)(ii)(C)(1) of this section, one on June 30, 2023 and the second on December 31, 2023. For each valuation, Fund reasonably expected to provide \$90x of retirement and pension benefits and \$100x of qualified benefits. In addition, in the year ending on December 31, 2026, pursuant to a valuation carried out under paragraph (c)(2)(ii)(C)(1) of this section, Fund reasonably expected to provide \$150x retirement and pension benefits and \$200x of qualified benefits.

(ii) Analysis. In each of the years ending on December 31, 2023, December 31, 2024, and December 31, 2025 (including the two valuations performed in 2023), the valuation performed pursuant to paragraph (c)(2)(ii)(C)(1) of this section demonstrates that the requirements of paragraph (c)(2)(ii)(B)(2) of this section have been met because \$90x of retirement and pension benefits constitutes 90 percent of the total \$100x of qualified benefits. For the year ending on December 31, 2026, the valuation performed pursuant to paragraph (c)(2)(ii)(C)(1) of this section does not demonstrate that the requirements of paragraph (c)(2)(ii)(B)(2) of this section have been met because \$150x of retirement and pension benefits constitutes 75 percent of the total \$200x of qualified benefits. Thus, Fund does not meet the requirements of paragraph (c)(2)(ii)(C)(1) of this section for the year ending on December 31, 2026. Under the 48-month alternative calculation in paragraph (c)(2)(ii)(C)(2) of this section, Fund also does not satisfy the requirement that it reasonably expects to provide 85 percent retirement and pension benefits to qualified recipients as of December 31, 2026. This is because

when averaging the values (not percentages) of the qualified benefits and retirement and pension benefits that Fund reasonably expected to provide from the valuations performed over the preceding 48 months (including the most recent valuation), Fund must use a weighted average whereby values are adjusted when the length of valuation periods differs. In this case, each of the two valuations in 2023 must be divided by two for a total weighted average for each valuation of \$45x retirement and pension benefits and \$50x of qualified benefits. When Fund then divides the total retirement and pension benefits that it reasonably expected to provide of \$420x (\$45x + \$45x + \$90x + \$90x + \$150x) by the total qualified benefits that it reasonably expected to provide of \$500x (\$50x + \$50x + \$100x + \$100x + \$200x), the average is 84 percent. Because Fund does not satisfy the requirements of paragraph (c)(2)(ii)(B)(2) of this section under the test in paragraph (c)(2)(ii)(C)(2) of this section or the test in paragraph (c)(2)(ii)(C)(1) of this section, Fund is not a qualified foreign pension fund with respect to the disposition on June 1, 2027. Because OpCo is not held by a qualified foreign pension fund as of the date of the disposition, OpCo is not a qualified controlled entity within the meaning of paragraph (e)(9) of this section. Accordingly, the \$100x of gain realized by OpCo is not exempt from tax under section 897(l).

(11) Example 11: Qualified foreign pension fund as qualified holder--(i) Facts. The facts are the same as in paragraph (f)(10) of this section (Example 10), except that OpCo does not dispose of Property A on June 1, 2027 and Fund reasonably expects to provide 85 percent of retirement and pension benefits to qualified recipients in the future in each of the annual present valuations it performs as of December 31, 2027 through December 31, 2033. Fund also satisfies the other requirements of paragraph (c)(2) of this section during this period. On April 1, 2029, Fund purchases Property B, a United States real property interest, and holds it in a qualified segregated account. On June 1, 2034, Fund realizes \$100x of gain on the disposition of Property B and OpCo realizes \$100x of gain on the disposition of Property A. At least 85 percent and no more than five percent of the actual value of the aggregate benefits provided by Fund before December 31, 2033, the most recent present value determination, were retirement and pension benefits and non-ancillary benefits, respectively.

(ii) Analysis. (A) Because Fund reasonably expected to provide 85 percent of retirement and pension benefits to qualified recipients as of the valuation performed on December 31, 2033, and it met the other requirements of paragraph (c)(2) of this section, Fund is a qualified foreign pension fund under paragraph (c)(2)(ii)(C)(3) of this section for the twelve months succeeding the most recent valuation, which includes June 1, 2034, the date of the disposition of Property A and Property B.

(B) Fund is a qualified holder under paragraph (d)(2) of this section because Fund did not own any United States real property interests as of December 31, 2027, the earliest date during the uninterrupted period ending on the date of the disposition, June 1, 2034, during which it satisfied the requirements of paragraph (c)(2) of this section and therefore qualified as a qualified foreign pension fund. Fund is eligible for the exemption under section 897(l) with respect to the disposition of Property B because it held Property B in a qualified segregated account. Thus, the \$100x of gain realized by Fund on the disposition of Property B is exempt from tax under section 897(l).

(C) Because OpCo owned Property A, a United States real property interest, as of December 31, 2027, the earliest date during an uninterrupted period ending on the date of the disposition, June 1, 2034, during which it was a qualified controlled entity, OpCo cannot satisfy the requirements of paragraph (d)(2) of this section and must

instead satisfy the requirements of paragraph (d)(3) of this section to be a qualified holder. The testing period with respect to OpCo, determined under paragraph (d)(3)(ii) of this section, ends on June 1, 2034 (the date of the disposition) and begins on June 1, 2024 (the date that is ten years before the disposition date). Because Fund failed to qualify as a qualified foreign pension fund as of December 31, 2026, OpCo was not continuously owned by a qualified foreign pension fund for the duration of the testing period, and thus did not qualify as a qualified foreign pension fund, part of a qualified foreign pension fund, or a qualified controlled entity for the duration of the testing period. As a result, OpCo is not a qualified holder under paragraph (d)(3) of this section. Accordingly, the \$100x of gain recognized by OpCo on the disposition of Property A is not exempt from tax under section 897(l).

(12) Example 12: Qualified controlled entity as qualified holder--(i) Facts. Fund is a qualified foreign pension fund organized in Country C that meets the requirements of paragraph (c)(2) of this section as of December 31, 2022 and December 31, 2023. Fund purchases an interest in Company A, a United States real property holding company, on June 1, 2024. As of December 31, 2024, Fund fails to satisfy the present valuation requirement of paragraph (c)(2)(ii)(B)(2) of this section and does not satisfy the alternative calculation under paragraph (c)(2)(ii)(C)(2) of this section. From December 31, 2025, through December 31, 2030, Fund satisfies the present valuation requirement of paragraph (c)(2)(ii)(B)(2) of this section and meets all other requirements in paragraph (c)(2) of this section to be treated as a qualified foreign pension fund. On June 1, 2026, Fund purchases all of the stock of Company B, a Country C corporation that owns no United States real property interests and is not a qualified foreign pension fund, a part of a qualified foreign pension fund, or a qualified controlled entity. On January 1, 2027, Company B purchases Property D, a United States real property interest. Company B retains or distributes to Fund all of its net earnings, and upon dissolution, must distribute all of its assets to its stockholders (that is, Fund) after satisfaction of liabilities to its creditors. On June 1, 2031, Fund realizes \$100x of gain on the disposition of stock in Company A, and Company B realizes \$100x of gain on the disposition of Property D.

(ii) Analysis. (A) Fund owned Company A, a United States real property holding company, as of December 31, 2025, the earliest date during an uninterrupted period ending on the date of the disposition, June 1, 2031, during which Fund satisfied the requirements of paragraph (c)(2) of this section. Accordingly, to be a qualified holder, Fund must satisfy the requirements of paragraph (d)(3) of this section. The testing period with respect to Fund, determined under paragraph (d)(3) of this section, ends on June 1, 2031 (the date of disposition) and begins on June 1, 2021 (the date that is ten years before the disposition date). Fund is not a qualified holder because it failed to satisfy the requirements of paragraph (c)(2) of this section as of December 31, 2024 and, thus, has not satisfied the requirements of paragraph (c)(2) of this section continuously for the duration of the testing period. Accordingly, the \$100x of gain realized by Fund on the disposition of the stock of Company A is not exempt from tax under section 897(l).

(B) Although Fund is not a qualified holder as of June 1, 2031, the date of Company B's disposition of Property D, Fund is still a qualified foreign pension fund because it satisfies the requirements of paragraph (c)(2) of this section. Company B is therefore a qualified controlled entity within the meaning of paragraph (e)(9) of this section as of June 1, 2031, because it is wholly owned by Fund, a qualified foreign pension fund. Notwithstanding that Fund is not a qualified holder under either paragraph

(d)(2) or (3) of this section, Company B is a qualified holder under paragraph (d)(2) of this section because Company B did not own a United States real property interest as of June 1, 2026, the earliest date during an uninterrupted period ending on June 1, 2031 (the date of the disposition) during which Company B was a qualified controlled entity. Lastly, all of Company B's assets constitute a qualified segregated account. Accordingly, the \$100x of gain realized by Company B on the disposition of Property D is exempt from tax under section 897(l).

(g) Applicability date--(1) In general. Except as otherwise provided in paragraph (g)(2) of this section, this section applies to dispositions of United States real property interests and distributions described in section 897(h) occurring on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

(2) Certain provisions. Paragraphs (b)(1), (d), (e)(5) and (e)(9) of this section apply with respect to dispositions of United States real property interests and distributions described in section 897(h) occurring on or after June 6, 2019.

(3) Early application. An eligible fund may choose to apply this section with respect to dispositions and distributions occurring on or after December 18, 2015, and before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, provided that the eligible fund, and all persons bearing a relationship to the eligible fund described in section 267(b) or 707(b), consistently apply the rules in this section for all relevant years. An eligible fund that chooses to apply this section pursuant to this paragraph (g)(3) must apply the principles of paragraph (d)(4)(i) of this section to any valuation requirements with respect to dates preceding December 18, 2015.

Par. 3. Section 1.1441-3 is amended by revising paragraphs (c)(4)(i) introductory text, (c)(4)(i)(B)(2), and (c)(4)(i)(C) and adding paragraph (c)(4)(iii) to read as follows:

§1.1441-3 Determination of amounts to be withheld.

* * * * *

(c) * * *

(4) * * *

(i) In general. A distribution from a U.S. Real Property Holding Corporation (USRPHC) (or from a corporation that was a USRPHC at any time during the five-year period ending on the date of distribution) with respect to stock that is a U.S. real property interest under section 897(c) or from a Real Estate Investment Trust (REIT) or other entity that is a qualified investment entity (QIE) under section 897(h)(4) with respect to its stock is subject to the withholding provisions under section 1441 (or section 1442 or 1443) and section 1445. A USRPHC (other than a REIT or other entity that is a QIE) making a distribution shall be treated as satisfying its withholding obligations under both sections if it withholds in accordance with one of the procedures described in either paragraph (c)(4)(i)(A) or (B) of this section. A USRPHC must apply the same withholding procedure to all the distributions made during the taxable year. However, the USRPHC may change the applicable withholding procedure from year to year. For rules regarding distributions by REITs and other entities that are QIEs, see paragraph (c)(4)(i)(C) of this section. To the extent withholding under sections 1441, 1442, or 1443 applies under this paragraph (c)(4)(i) to any portion of a distribution that is a withholdable payment, see paragraph (a)(2) of this section for rules coordinating withholding under chapter 4.

* * * * *

(B) * * *

(2) Withhold under section 1445(e)(3) and §1.1445-5(e) on the remainder of the distribution (except for any portion paid to a withholding qualified holder (as defined in §1.1445-1(g)(11)) or on such smaller portion based on a withholding certificate obtained in accordance with §1.1445-5(e)(3)(iv).

(C) Coordination with REIT/QIE withholding. In the case of a distribution from a REIT or other entity that is a QIE, withholding is required as described in paragraph (c)(4)(i)(C)(1) and (2) of this section.

(1) Withholding is required under section 1441 (or 1442 or 1443) on--

(i) The portion of the distribution that is not designated (for REITs) or reported (for regulated investment companies that are QIEs) as a capital gain dividend, a return of basis, or a distribution in excess of a shareholder's adjusted basis in the stock of the REIT or QIE that is treated as a capital gain under section 301(c)(3); and

(ii) Any portion of a capital gain dividend from a REIT or other entity that is a QIE that is not treated as gain attributable to the sale or exchange of a U.S. real property interest pursuant to the second sentence of section 897(h)(1)).

(2) Withholding is required under section 1445 with respect to--

(i) A distribution in excess of a shareholder's adjusted basis in the stock of the REIT or QIE is, unless the interest in the REIT or QIE is not a U.S. real property interest (for example, an interest in a domestically controlled REIT or QIE under section 897(h)(2)) or the distribution is paid to a withholding qualified holder (as defined in §1.1445-1(g)(11)); and

(ii) Any portion of a capital gain dividend that is attributable to the sale or exchange of a U.S. real property interest under section 897(h)(1), unless it is paid to a withholding qualified holder (as defined in §1.1445-1(g)(11)). See §1.1445-8.

* * * * *

(iii) Applicability date. Paragraphs (c)(4)(i), (c)(4)(i)(B)(2), and (c)(4)(i)(C) of this section apply to distributions made by a USRPHC or a QIE occurring on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. For distributions made by a USRPHC or a QIE occurring before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, see §1.1441-3(c)(4)(i), (c)(4)(i)(B)(2), and (c)(4)(i)(C), as contained in 26 CFR part 1, revised as of April 1, 2021.

* * * * *

Par. 4. Section 1.1445-1 is amended by adding paragraph (g)(11) to read as follows:

§1.1445-1 Withholding on dispositions of U.S. real property interests by foreign persons: In general.

* * * * *

(g) * * *

(11) Withholding qualified holder. A withholding qualified holder means a qualified holder (under §1.897(l)-1(d)), and a foreign partnership all of the interests of which are held by qualified holders (under §1.897(l)-1(d)), including through one or more partnerships.

* * * * *

Par. 5. Section 1.1445-2 is amended by:

1. Revising paragraph (b)(2)(i);
2. Adding paragraph (b)(2)(vi); and
3. Adding two sentences at the end of paragraph (e).

The revisions and addition read as follows:

§1.1445-2 Situations in which withholding is not required under section 1445(a).

* * * * *

(b) * * *

(2) * * *

(i) In general. The rules in this paragraph (b)(2)(i) apply for purposes of the transferor's certification of non-foreign status (including a certification of non-foreign status provided by a withholding qualified holder (as defined in §1.1445-1(g)(11))).

(A) A transferee of a U.S. real property interest is not required to withhold under section 1445(a) if, before or at the time of the transfer, the transferor furnishes to the transferee a certification that is signed under penalties of perjury and –

(1) States that the transferor is not a foreign person; and

(2) Sets forth the transferor's name, identifying number and home address (in the case of an individual) or office address (in the case of an entity).

(B) For purposes of paragraph (b)(2)(i)(A) of this section, a foreign person is a nonresident alien individual, foreign corporation, foreign partnership, foreign trust, or foreign estate, except that a withholding qualified holder (as defined in §1.1445-1(g)(11)) is not a foreign person. Additionally, a foreign corporation that has made a valid election under section 897(i) is generally not treated as a foreign person for purposes of section 1445. In this regard, see §1.1445-7. Pursuant to §1.897-1(p), an individual's identifying number is the individual's Social Security number and any other person's identifying number is its U.S. employer identification number (EIN), or, if the transferor is a withholding qualified holder (as defined in §1.1445-1(g)(11)) that does not have a U.S. taxpayer identification number, a foreign tax identification number issued by its jurisdiction of residence. A certification pursuant to this paragraph (b) must be verified as true and signed under penalties of perjury by a responsible officer in the case of a corporation, by a general partner in the case of a partnership, and by a trustee, executor, or equivalent fiduciary in the case of a trust or estate. No particular form is needed for a certification pursuant to this paragraph (b), nor is any particular language required, so long as the document meets the requirements of this paragraph (b)(2)(i), except that, with respect to a certification submitted by a withholding qualified holder (as defined in §1.1445-1(g)(11)), the transferor must state on the certification that it is treated as a non-foreign person because it is a withholding qualified holder and must further specify whether it qualifies as a withholding qualified holder because it is a qualified holder under §1.897(l)-1(d) or a foreign partnership that satisfies the requirements of §1.1445-1(g)(11). Samples of acceptable certifications are provided in paragraph (b)(2)(iv) of this section.

* * * * *

(vi) Form W-8EXP. A certification of non-foreign status may be made by a withholding qualified holder (as defined under §1.1445-1(g)(11)) as provided in paragraph (b)(2)(i) of this section to certify its qualified holder status. A certification of non-foreign status under paragraph (b)(2)(i) of this section also includes a certification made on a Form W-8EXP (or its successor) that states that the transferor is treated as a non-foreign person because it is a withholding qualified holder and must further specify whether it qualifies as a withholding qualified holder because it is a qualified holder under §1.897(l)-1(d) or a foreign partnership that satisfies the requirements of §1.1445-1(g)(11). The certification must also meet all of the other requirements for a valid Form W-8EXP (or its successor) as provided on the form and the instructions to the form. A qualified holder may not provide a certification of non-foreign status on a Form W-9 (or its successor) as permitted in paragraph (b)(2)(v) of this section.

* * * * *

(e) * * * Paragraphs (b)(2)(i) and (b)(2)(vi) of this section, apply with respect to dispositions of U.S. real property interests and distributions described in section 897(h) occurring on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. For dispositions of U.S. real property interests and distributions described in section 897(h) occurring before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, see §1.1445-2(b)(2)(i) and (b)(2)(vi), as contained in 26 CFR part 1, revised as of April 1, 2021.

Par. 6. Section 1.1445-5 is amended by revising paragraphs (b)(3)(ii)(A), (B), and (D) and adding two sentences at the end of paragraph (h) to read as follows:

§1.1445-5 Special rules concerning distributions and other transactions by corporations, partnerships, trusts, and estates.

* * * * *

(b) * * *

(3) * * *

(ii) * * *

(A) In general. For purposes of this section, an entity or fiduciary may treat any holder of an interest in the entity as a U.S. person if that interest-holder furnishes to the entity or fiduciary a certification stating that the interest-holder is not a foreign person, in accordance with the provisions of paragraph (b)(3)(ii)(B) of this section. In general, a foreign person is a nonresident alien individual, foreign corporation, foreign partnership, foreign trust, or foreign estate, except that a withholding qualified holder (as defined in §1.1445-1(g)(11)) is not a foreign person for purposes of this section.

(B) Procedural rules. The rules in this paragraph (b)(3)(ii)(B) apply for purposes of the interest-holder's certification of non-foreign status (including a certification of non-foreign status provided by a withholding qualified holder (as defined in §1.1445-1(g)(11))).

(1) An interest-holder's certification of non-foreign status must be signed under penalties of perjury and must state –

(i) That the interest-holder is not a foreign person; and

(ii) The interest-holder's name, identifying number, home address (in the case of an individual), or office address (in the case of an entity), and place of incorporation (in the case of a corporation).

(2) For purposes of paragraph (b)(3)(ii)(B)(1) of this section, an individual's identifying number is the individual's Social Security number and any other person's identifying number is its U.S. employer identification number (see § 1.897-1(p)), or, if the interest-holder is a withholding qualified holder (as defined in §1.1445-1(g)(11)) that does not have a U.S. taxpayer identification number, a foreign tax identification number issued by its jurisdiction of residence. The certification must be signed by a responsible officer in the case of a corporation, by a general partner in the case of a partnership, and by a trustee, executor, or equivalent fiduciary in the case of a trust or estate. No

particular form is needed for a certification pursuant to this paragraph (b)(3)(ii), nor is any particular language required, so long as the document meets the requirements of this paragraph, except that, with respect to certification submitted by a withholding qualified holder (as defined in §1.1445-1(g)(11)), the transferor must state on the certification that it is treated as a non-foreign person because it is a withholding qualified holder and must further specify whether it qualifies as a withholding qualified holder because it is a qualified holder under §1.897(l)-1(d) or a foreign partnership that satisfies the requirements of §1.1445-1(g)(11). Samples of acceptable certifications are provided in paragraph (b)(3)(ii)(E) of this section.

(3) An entity may rely upon a certification pursuant to this paragraph (b)(3)(ii)(B) for a period of two calendar years following the close of the calendar year in which the certification was given. If an interest holder becomes a foreign person (or no longer is treated as a withholding qualified holder (as defined in §1.1445-1(g)(11)) and therefore is no longer treated as a non-foreign person for purposes of withholding under section 1445 within the period described in the preceding sentence, the interest-holder must notify the entity before any further dispositions or distributions and upon receipt of such notice (or any other notification of the foreign status of the interest-holder) the entity may no longer rely upon the prior certification. An entity that obtains and relies upon a certification must retain that certification with its books and records for a period of three calendar years following the close of the last calendar year in which the entity relied upon the certification.

* * * * *

(D) Form W-8EXP. A certification of non-foreign status can be made by a withholding qualified holder (as defined in §1.1445-1(g)(11)) as provided in this paragraph (b)(3)(ii) to certify its qualified holder status. A certification of non-foreign status under this paragraph (b)(3)(ii) also includes a certification made on a Form W-

8EXP that states that the interest-holder is treated as a non-foreign person because it is a withholding qualified holder and must further specify whether it qualifies as a withholding qualified holder because it is a qualified holder under §1.897(l)-1(d) or a foreign partnership that satisfies the requirements of §1.1445-1(g)(11). The certification must also meet all of the other requirements for a valid Form W-8EXP as provided on the form and the instructions to the form. A qualified holder may not provide a certification of non-foreign status on a Form W-9, as described in paragraph (b)(3)(iv) of this section.

* * * * *

(h) * * * Paragraph (b)(3)(ii)(A) of this section applies with respect to dispositions of U.S. real property interests and distributions described in section 897(h) occurring on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. For dispositions of U.S. real property interests and distributions described in section 897(h) occurring before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, see §1.1445-5(b)(3)(ii)(A), as contained in 26 CFR part 1, revised as of April 1, 2021.

Par. 7. Section 1.1445-8 is amended by revising paragraph (e) and adding two sentences after the first sentence in paragraph (j) to read as follows:

§1.1445-8 Special rules regarding publicly traded partnerships, publicly traded trusts and real estate investment trusts (REITs).

* * * * *

(e) Determination of non-foreign status by withholding agent. A withholding agent may rely on a certification of non-foreign status pursuant to §1.1445-5(b)(3)(ii) to determine whether an interest holder is not a foreign person. Reliance on these documents will excuse the withholding agent from liability imposed under section 1445(e)(1) in the absence of actual knowledge that the interest holder is a foreign person. A withholding agent may also employ other means to determine the status of an interest holder, but, if the agent relies on such other means and the interest holder

proves, in fact, to be a foreign person (or, is not a withholding qualified holder (as defined in §1.1445-1(g)(11)) and therefore is not treated as a non-foreign person for purposes of withholding under section 1445), then the withholding agent is subject to any liability imposed pursuant to section 1445 and the regulations thereunder for failure to withhold. See also §1.1445-5(b)(3)(ii)(B)(3) for the period during which a withholding agent may rely on a certification of non-foreign status submitted by a withholding qualified holder (as defined in §1.1445-1(g)(11)), which applies under this paragraph (e).

* * * * *

(j) * * * Paragraph (e) of this section applies with respect to distributions made on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. For distributions made before **[INSERT DATE OF PUBLICTAION IN THE FEDERAL REGISTER]**, see §1.1445-8(e) as contained in 26 CFR part 1, as revised April 1, 2021.*

* *

Par. 8. Section 1.1446-1 is amended by revising the second sentence of paragraph (c)(2)(ii)(G) and by revising paragraph (c)(2)(ii)(H) to read as follows:

§1.1446-1 Withholding tax on foreign partners' share of effectively connected taxable income.

* * * * *

(c) * * *

(2) * * *

(ii) * * *

(G) * * * However, except as set forth in §1.1446-2(b)(4)(iii) (regarding withholding qualified holders (as defined in §1.1445-1(g)(11)) and §1.1446-3(c)(3) (regarding certain tax-exempt organizations described in section 501(c)), the submission of Form W-8EXP (or successor) will have no effect on whether there is a 1446 tax due with respect to such partner's allocable share of partnership ECTI. * * *

(H) Foreign corporations, certain foreign trusts, and foreign estates. Consistent with the rules of this paragraph (c)(2) and paragraph (c)(3) of this section, a foreign corporation, a foreign trust (other than a foreign grantor trust described in paragraph (c)(2)(ii)(E) of this section), or a foreign estate may generally submit any appropriate Form W-8 (for example, Form W-8BEN-E or Form W-8IMY) to the partnership to establish its foreign status for purposes of section 1446. In addition, a foreign entity may also submit a certification of non-foreign status (including a Form W-8EXP) described in §1.1445-5(b)(3)(ii) for purposes of documenting itself as a withholding qualified holder (as defined in §1.1445-1(g)(11)).

* * * * *

Par. 9. Section 1.1446-2 is amended by adding paragraph (b)(4)(iii) to read as follows:

§1.1446-2 Determining a partnership's effectively connected taxable income allocable to foreign partners under section 704.

* * * * *

(b) * * *

(4) * * *

(iii) Special rule for qualified holders. With respect to a foreign partner that is a withholding qualified holder (as defined in §1.1445-1(g)(11)), the foreign partner's allocable share of partnership ECTI does not include gain or loss that is not taken into account under §1.897(l)-1(b) and that is not otherwise treated as effectively connected with a trade or business in the United States. The partnership must have received from the partner a valid certificate of non-foreign status (including a Form W-8EXP) described in §1.1445-2(b)(2)(i) or §1.1445-5(b)(3)(ii). See §1.1446-1(c)(2)(ii)(G) and (H) regarding documentation of withholding qualified holders.

* * * * *

Par. 10. Section 1.1446-7 is amended by adding two sentences at the end to read as follows

§1.1446-7 Applicability dates.

* * * Sections 1.1446-1(c)(2)(ii)(G) and (H) and 1.1446-2(b)(4)(iii) apply with respect to dispositions of U.S. real property interests and distributions described in section 897(h) occurring on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. For dispositions of U.S. real property interests and distributions described in section 897(h) occurring before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, see §§1.1446-1(c)(2)(ii)(G) and (H), as contained in 26 CFR part 1, revised as of April 1, 2021.

Melanie R. Krause,

Acting Deputy Commissioner for Services and Enforcement.

Approved: December 9, 2022

Lily Batchelder,

Assistant Secretary of the Treasury (Tax Policy).